

Giuseppe Sigillò Massara

Transfer of Undertakings, Insolvency Proceedings in the United Kingdom and Italy, and the European Court of Justice Case Law



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Giuseppe Sigillò Massara¹

Abstract

The current paper explores the application and revision process of the Acquired Rights Directive in the context of insolvency proceedings, focusing on the role of community and national (British and Italian) case law. It therefore analyzes, from a comparative perspective, the inevitable conflict between these disciplines, and the related implementation of the EU Directive in Italy and in the United Kingdom.

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Editorial notes

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1. Introduction

This work analyzes the impact of Directive 77/187/EEC² (hereinafter referred to as the “Acquired Rights Directive” or the “Directive”) on insolvent companies and the long and difficult process of revising the Directive. This process has recently led to the adoption of Directive 98/50/EC³ (the “Amending Directive”) by the Council of the European Communities.

The European Court of Justice (“ECJ”) and the national courts of the Member States have been the principal actors of the revision process. The importance of both the ECJ and national case law is demonstrated by the fact that the Amending Directive has modified and replaced numerous provisions of the Acquired Rights Directive on the basis of principles developed by the ECJ in response to the wishes of national judges. This work will, therefore, focus on the pronouncements of the European Court of Justice (“ECJ”) as well as those of British and Italian courts attempting to define the scope of the Directive with regard to insolvent companies.

The Directive introduced the principle of compulsory transfer of employment relationships and associated liabilities upon the transfer of an undertaking⁴. However, it did not include any express provision concerning insolvent companies. The problem arising in the context of transfers of insolvent undertaking is to strike a balance between the acquired rights of the insolvent company’s employees and the interests of other creditors. The employees of an insolvent company are probably those who are most in need of protection. However, the application of the Directive to insolvent business transfers would only benefit the employees whose claims are met in full to the detriment of other creditors. In addition, the prospect of taking over liabilities connected to employment contracts would either deter potential transferees from purchasing the insolvent business or cause the transferor to discount the price which potential transferees would be otherwise prepared to pay. In the first case, where no purchaser is found, creditors would probably prefer to sell the

² OJ 1977 L 61/27, Council Directive 77/187/EEC on the approximation of the laws of the Member States relating to the safeguarding of employees’ rights in the event of the transfer of undertakings, businesses, or parts of businesses.

³ OJ 1998 L 201/88.

⁴ Art. 3 (1).

assets of the undertaking separately. As a consequence, the entire workforce would be dismissed, and the application of the Directive would have the opposite effect of that which was intended. In the second case, where the transferee pays less for the business transferred, the assets in the transferor's hands would be diminished to the detriment of the transferor's creditors.

In cases which came before it, the European Court of Justice extensively interpreted the Acquired Rights Directive so as to ensure, or at least with the intention of ensuring, that the balance between the interests of employees and creditors was weighted in favour of the protection of employees' rights. The ECJ held the Directive applicable to a number of insolvency proceedings.

British and Italian courts took a different approach in regards to the rulings of the ECJ. Italian courts carried out a direct dialogue with the European Court. They often referred to the ECJ for preliminary rulings, and made substantial efforts to read the pre-existing national law in light of ECJ's rulings. British courts, on the other hand, did not make any reference to the ECJ for preliminary rulings. Nevertheless, they have interpreted national law pursuant to ECJ case law, adapting the latter to the specific domestic background.

Both British and Italian courts and national academic writers have emphasized the problems arising from the application of the Directive to insolvent business transfers. After a long, difficult process of revising the 1977 Directive, the Amending Directive has been adopted. It modifies the Acquired Rights Directive, consolidating the case law of the ECJ. In the area of insolvency, the changes are essentially deregulatory. In a number of key issues, Member States are granted a wide degree of discretion in applying the Directive itself.

The structure of the current work follows the process of the revision of the Acquired Rights Directive. Therefore, after a brief analysis of the relevant provisions of the Directive itself, it presents an investigation and elucidation of the criteria for excluding insolvent companies from the application of the Directive as set forth by the ECJ. Some of the most relevant pronouncements of the ECJ will be examined in detail in order to show how the European Court has widely interpreted the Directive. The criticisms of the expansive approach of the ECJ will also be taken into account.

Part 2, following a brief analysis of the pre-Directive situation, concentrates on the implementation of the Directive in the United Kingdom, and the rele-

vant Transfer of Undertakings (Protection of Employment) Regulations of 1981 are analyzed. The mechanism of “hiving-down” is also examined. Indeed, only with regard to “hiving-down”, in the possible clash between the interests of the company’s creditors and the employees’ acquired rights, was granted absolute priority to the former. Next is an analysis of how British courts have applied the case law of the ECJ and the principles that the Court has established as well as which UK insolvency proceedings have been recognized as falling outside the scope of the Directive.

Part 3 concerns the implementation of the Directive in Italy. First, the section focuses on prior national law and, in particular, on Article 2112 of Italian Civil Code which, since 1942, endorsed the principle of compulsory transfer of contracts of employment upon the transfer of an undertaking. This is followed by a detailed analysis of Article 47 of Law No. 428 of 1990, which implemented the Acquired Rights Directive in Italy. Particular attention is drawn to paragraph 5 of Article 47 of Law No. 428 of 1990. This paragraph was introduced in 1990 following the already existing case law of the ECJ and provided for derogation from article 2112 of Italian Civil Code in the case of insolvent business transfers. In the last section of Part 3, the approach adopted by the Italian courts in comparison to British courts is analyzed.

Finally, Part 4 is focused on recent amendments to the Directive and, in particular, on the changes in relation to the transfer of insolvent businesses. Emphasis is on how the Amending Directive exemplifies the Community’s current “light touch” approach to labor legislation. The new Article 4a inserted in the 1977 text and the impact of the Amending Directive of employees’ rights are examined. An update on the transposition process in the UK and Italy is given and a few general points on the process of revising the 1977 Directive are made by way of conclusion.

2. Transfer of undertakings and insolvency proceedings in the interpretation of the European Court of Justice

2.1 Outline of the relevant provisions of the Acquired Rights Directive

The Acquired Rights Directive constituted a legislative response to concerns over the impact of business restructuring – taking place in the late 1970s throughout the territory of the Community – on affected employees. The primary purpose of the Directive was “to provide for the protection of employees in the event of a change of employer, in particular to ensure that their rights were safeguarded”⁵.

The Directive was also designed to achieve a particular economic objective which, as Barnard has identified, was to “assist the process of restructuring, allowing more competitive and efficient undertakings to emerge. Consequently, the managerial right to restructure and to dismiss employees was never questioned”⁶. The operation of this “managerial right” was nevertheless constrained under the Directive.

First, the Directive states that the employees’ representatives are to be informed and consulted in the event that a transfer is foreseen. Beyond such consultation rights, Article 3 (1) sets out the principal effect of the transfer of an undertaking in respect to the employees. It provides for the automatic transfer from the transferor to the transferee of all the transferor’s rights and obligations arising from a contract of employment or from an employment relationship existing on the date of the transfer.

The Directive, then, declares that the transfer of an undertaking “shall not in itself constitute grounds for dismissal” of an employee by either the transferor or the transferee⁷. This protection against dismissal is not absolute. It does not cover dismissals taking place for “economic, technical or organisational reasons”.

⁵ As stated in the preamble of the Directive.

⁶ Barnard, Catharine, *EC Employment Law* (Oxford University Press: Second Edition 2000), at 445.

⁷ Article 4(1).

2.2 Application of the Directive to transfers of insolvent companies by the European Court of Justice

The Acquired Rights Directive makes no express provision for the position of companies which are transferred in the context of insolvency proceedings. The ECJ attempted to define the scope of the Directive in this regard in several judgments.

2.2.1 The Abels case: Insolvency and pre-insolvency proceedings

In *Abels*⁸, the ECJ was called on to decide whether the scope of the Directive extended to a situation in which the transferor of an undertaking was insolvent or was granted a “*surseance van betaling*” (judicial leave to suspend payment of debts) under the Netherlands legislation.

To an English lawyer, this could appear to be a surprising question: the English version of the Directive states that it applies to “a legal transfer or merger”, so there is no reason to exclude transfers by insolvent transferors. In domestic UK law, which has implemented the Directive, the concept of legal transfer has been interpreted so as to mean a transfer “effected by sale or by some other disposition or by operation of law”⁹. This again suggests no exclusion of transfer by insolvent companies. However, a number of Member States – including Italy – have translated the Directive in their language as applying only to contractual transfer (“*cessione contrattuale*” in the Italian version). Transfers by insolvent companies are not consensual and so should be outside the scope of the Directive.

Because of those differences in the various versions of the Directive, the ECJ, in *Abels*, refused to adopt a textual interpretation. It referred, first, to the relationship between the Directive and the rules of insolvency and, secondly, to the purpose of the Directive itself.

As the ECJ noted, in all Member States the insolvency law consists of specific rules, which may except, at least partially, from other provisions of a general nature, including provisions of social law. The specificity of insolvency law

⁸ Case C-135/83 H.B.M. *Abels v The Administrative Board of the Bedrijfsvereniging voor de Metaalindustrie en de Electrotechnische Industrie* [1985] ECR 469.

⁹ Regulation 3 (2) of Transfer of Undertakings (Protection of Employment) Regulations 1981.

is also confirmed in community law¹⁰. For those reasons, the Court stated that “if the directive had been intended to apply also to transfers of undertakings in the context of such proceedings, an express provision would have been included for that purpose”¹¹.

The Court went on to examine the purpose of the Directive. It determined that the purpose was to ensure that the restructuring of undertakings within the common market does not adversely affect workers in the undertakings in regards to the need (referred to in Art. 117 of the EEC Treaty) “to promote improved working conditions and an improved standard of living for workers”.

In this regard, the Court recognized that it was not clear whether the application of the Directive to insolvent companies would have been favorable or prejudicial to the interests of employees. On the one hand, employees whose employer has been judged to be insolvent are precisely those who are most in need of protection. On the other hand, such an extension of the scope of the Directive might dissuade a potential transferee from acquiring an undertaking on conditions acceptable to the creditors. In such a situation, creditors would probably prefer to sell the assets of the undertaking separately. The consequence will be the loss of all jobs in the undertaking, detracting from the usefulness of the Directive.

Therefore, the ECJ concluded that the Directive did not impose on Member States the obligation to extend the rules laid down therein to the transfer of undertakings, businesses, or parts of businesses taking place in the context of insolvency proceedings which are instituted in view of the liquidation of the assets of the transferor under the supervision of the competent judicial authority. Nevertheless, as the Court clarified, the Member States were free to apply the principles of the Directive, wholly or in part, on the basis of their national law. The question submitted by the national court also raised the question of whether a transfer, taking place in proceedings such as a “surseance van betaling”, fell outside the scope of the Directive.

¹⁰Article 1.2 (d) of Council Directive 75/129/EEC, relating to collective redundancies, expressly excludes from its scope workers affected by termination of an establishment activities “where that is the result of a judicial decision”. Moreover, the Council has adopted Directive 80/987/EEC specifically relating to the protection of employees in the event of the insolvency of their employer.

¹¹ [1985] ECR 469 para. 17.

The Court noted that “proceedings such as those relating to a *surseance van betaling* have certain features in common with liquidation proceedings, in particular inasmuch as the proceedings are, in both cases, of a judicial nature”¹². However, as the ECJ found out, they are different from liquidation proceedings “in so far as the supervision exercised by the court over the commencement and the course of such proceedings is more limited”. Moreover, such proceedings, in the ECJ’s opinion, aim to safeguard the assets of the insolvent undertaking and, where possible, to continue the business of the undertaking. Only when such continuation is no longer possible can proceedings of this kind, as in *Abels*, lead to the liquidation of the debtor.

The ECJ concluded that the reasons for not applying the Directive to the transfer of undertakings taking place in liquidation proceedings were not applicable to proceedings such as a “*surseance van betaling*” which took place at an earlier stage¹³.

The Court confirmed its judgement in *Abels* regarding three other judgments delivered on the same day¹⁴. After those judgments, it was widely thought that all transfers related to insolvency proceedings were removed from the scope of the Directive. However, this view has been fundamentally altered by the subsequent decision of the ECJ in *D’Urso & ors v Ercole Marelli Elettromeccanica Generale SpA. & Ors*¹⁵.

2.2.2 D’Urso: The transfer of a business subject to special creditors’ arrangement procedures

In this case, the ECJ was required to decide whether the Directive applied to transfers of undertakings subject to the Italian “special administration” procedure. The Court referred to its earlier judgement in *Abels* and held that that the decisive test used to establish whether the Directive did or did not apply was the purpose of the procedure in question. The Directive does not apply to proceedings designed to liquidate the transferor’s assets, but does apply to pro-

¹² [1985] ECR 469 para. 28.

¹³ [1985] ECR 469 para. 29.

¹⁴ Case C-19/83 *Knud Wendelboe and Others v L.J. Music ApS in liquidation* [1985] ECR 457; Case C-179/83 *Industriebond FNV and Another v Netherlands State* [1985] ECR 511; Case C-186/83 *Arie Botzen and Others v Rotterdamsche Droogdok Maatschappij BV* [1985] ECR 519.

¹⁵ Case C-362/89 [1991] ECR I-4105

ceedings whose main purpose is to safeguard the assets and, where possible, to continue the business of the undertaking.

The ECJ went on to analyze the purpose of the “*special administration procedure*”¹⁶. The Italian “*special administration procedure*” applies to large undertakings which the judicial authorities have determined to be in a state of insolvency or to have failed to pay salaries during a period of three months, and are governed by the provision of Italian law on compulsory administrative winding-up.

The Court noted that the ministerial decree, which sets the procedure in motion, has, or may have, two kinds of effects. It can set forth a procedure for the compulsory administrative liquidation of the undertaking’s assets in order to settle creditors’ claims on the company. Compulsory administrative liquidation has effects which, in substance, are identical to those of bankruptcy proceedings. Alternatively, as in *D’Urso*, the decree may also authorize the undertaking to continue trading under the supervision of a receiver for a period of time.

The Court held that the special administration of large undertakings in critical difficulty has different characteristics depending on whether or not the decree authorizes the undertaking to continue trading:

“If no decision is taken on that last matter or if the period of validity of a decision authorising the undertaking to continue trading has expired, like insolvency proceedings, that procedure is designed to liquidate the debtor’s assets in order to satisfy the body of creditors” and “transfers effected under this legal framework are consequently excluded from the scope of the Directive”.

When the decree authorizes the undertaking to continue trading under the supervision of an auditor, the primary purpose is to give the undertaking some stability, allowing its future activity to be safeguarded. In this case, as the ECJ concluded, the Directive does apply. In *D’Urso*, the ECJ clarified the scope of the exclusion envisaged in *Abels*. It made clear that it is not the degree of control exercised by the judicial or administrative authority over the procedure that determines when the Directive applies, but the purpose of the insolvency procedure in question.

When the procedure in question aims to liquidate the debtor’s property by realizing the assets in order to satisfy the creditors, the Directive does not ap-

¹⁶ See chapter III, para. 3.4.

ply. Those procedures are generally characterized by very wide judicial control, preventing the debtor from exercising his power of dealing with and managing his assets with the aim of safeguarding assets and protecting the interests of creditors. When the procedure in question aims to deal with temporary difficulties in order to enable the undertaking to continue to trade, the Directive does apply. Generally speaking, in those procedures, the judicial control is limited in scope without preventing the debtor from dealing with or managing the assets. That type of procedure might result in a declaration of insolvency, but the possibility is not enough to exclude the application of the Directive. As stated by Advocate-General Van Gerven in *D'Urso*, "it is not enough that the preconditions for the insolvency of the transferor are fulfilled for a transfer to be excluded from the scope of the Directive".

It would not be correct to conclude that the ECJ merely confirmed its previous approach in *Abels*. Rather, *D'Urso* can be considered as "a strengthening of its previous position"¹⁷. The ECJ "took (silently) another step towards extending the scope of the Directive"¹⁸.

2.2.3 Spano: The transfer of an undertaking in critical difficulties

The Court reaffirmed its *D'Urso* decision in *Spano and Others v Fiat Geotech and Fiat Hitachi*¹⁹. In this case, the European Court of Justice was required to verify whether Article 47 (5) of Italian Law No. 428 of 1990 was consistent with the Directive.

Such a provision applies to undertakings declared by the Ministerial Committee for the Co-ordination of Industrial Policy (hereinafter referred to as "CIP") to be in critical difficulty²⁰. It introduced derogation from Article 2112 of the Italian Civil Code. This article provides that, in the event of the transfer of an undertaking, employment relationships are to continue to exist with the new owner and that the employees' rights under those relationships are to be preserved.

¹⁷ Leccese, Vito, "Italian Courts, the ECJ and Transfers of Undertakings: A Multi-Speed Dialogue?" (1999) 5 EuLJ 315 at 320.

¹⁸ *Ibid.*

¹⁹ Case C-472/93 [1995] ECR I-4321

²⁰ Pursuant to Article 2 (5) (c) of Italian law No. 675 of 1977.

The ECJ recalled its rulings in *Abels* and *D'Urso* and held that the determining factor to be taken into consideration in deciding whether the Directive applied was the purpose of the procedure in question. In the Court's view, the purpose of declaring that an undertaking is facing critical difficulties is to enable the undertaking itself to retrieve its economic and financial situation and, above all, to preserve jobs. A declaration by the CIPI that an undertaking is facing critical difficulties is conditional upon the submission of a recovery plan. An undertaking found to be in critical difficulties is subject to a procedure which, far from being aimed at the liquidation of the undertaking, is designed, on the contrary, to promote the continuation of its business in view of its subsequent recovery. Unlike insolvency proceedings, an undertaking declared to be facing critical difficulties is not subject to any judicial supervision or any measure whereby the assets of the undertaking are put under administration, and no suspension of payments is granted.

For those reasons, the Court concluded that *"the economic and social objective pursued by that procedure cannot explain or justify the circumstance that, when all or part of the undertaking concerned is transferred, its employees lose the rights which the directive confers on them"*.

2.2.4 The Déthier case: Transfer of undertakings and judicial winding-up

The Court was obliged to give more detailed guidance about the nature of the distinction between insolvency and pre-insolvency proceedings in the *Déthier Equipment* case²¹. In this case, the national court raised the question of whether the Acquired Rights Directive applied to the transfer of an undertaking which was wound-up by the court pursuant to Belgian law.

Under Belgian law, the procedure for winding-up companies takes place after the dissolution of a commercial company²². It is designed to allow the company to conclude business transactions already entered into while precluding it, as a rule, from engaging in new business. Following their dissolution, commercial companies are deemed to exist for the purposes of liquidation even if they

²¹ Case C-319/94 [1998] ECR I-1061.

²² See Articles 178 to 188 of the *Lois Coordonnées sur les Sociétés Commerciales* (Consolidated Laws on Commercial Companies).

have already ceased all trading. Dissolution automatically brings to an end the functions of all organs of the company, which are replaced by one or more liquidators. The liquidators are appointed by the members in a general meeting²³ or, if the majority laid down by the law is not obtained, by the court. In the first case, the liquidation is called voluntary winding-up (“liquidation volontaire”). In the second it is referred to as winding-up by the court (“liquidation judiciaire”).

In his opinion, Advocate General Lenz stated that the judgments in *D’Urso* and *Spano* could not simply be applied without further qualification of the liquidation. In those cases, the Court had considered the purpose of the continuation of the business to be a decisive criterion for the application of the Directive. Advocate General Lenz concluded that the continuation of trading itself, and not the aim pursued by the continuation of the trading, was decisive. To the extent that the undertaking in liquidation continues trading, neither the fact of putting it into liquidation nor the fact that continuation of trading is aimed at the liquidation of the undertaking, and not its survival, can justify the loss by its employees of the rights which the Directive confers upon them.

This is the opinion that the Court followed. It concluded from the foregoing case law that the determining factor to be taken into consideration in deciding whether the Directive applies to the transfer of an undertaking subject to an administrative or judicial procedure is the purpose of the procedure in question. Following the opinion of the Advocate General, the Court stated that if the purpose of the procedure is not immediately conclusive, then account should be taken of the form of the procedure in question (in particular in so far as it means that the undertaking continues or ceases trading), and of the Directive's objectives.

Therefore, the Court first examined the purpose of the procedure for winding-up by the court, which it did not consider decisive in itself for the resolution of the case. It then examined the characteristic features of that procedure.

With regard to the purpose of the procedure, the Court determined that the objective of the winding-up by the Belgian court is liquidation by realizing the company's assets for the benefit of the company itself and of its creditors. Liabilities exceeding assets is not a condition for putting a company into liquidation.

²³ Unless they are already named in the company's articles of association.

tion. Although liquidation may be a stage which precedes insolvency, it can also occur, as the Belgian Government stated, when the members no longer wish to cooperate. So, while the purpose of winding-up by a court under Belgian law may sometimes be similar to that of insolvency proceedings, this is not conclusive. Liquidation proceedings may be used whenever it is wished to bring a company's activities to an end and whatever is the reason for that course.

The Court went on to consider the form of the procedure in question. The Court noted that the undertaking continued to trade while it was being wound-up by the court. In such circumstances, continuity of the business was assured when the undertaking was transferred. There was, therefore, no justification for depriving employees of the rights guaranteed under the Directive.

2.2.5 The *Europièces* case: Transfer of undertakings and voluntary winding-up

In *Europièces*²⁴, the Court applied its ruling in *Déthier* to the case of voluntary liquidation. In this case, the domestic court referred to the European Court of Justice for a preliminary ruling on the question of whether the Directive applied when a company in voluntary liquidation, under Belgian law, had transferred all or part of its assets to another company.

As the ECJ pointed out, voluntary liquidation is essentially similar to winding-up by the court, save for the fact that it falls to the shareholders in general meeting, and not to the court, to make the decision to wind-up the company, appoint the liquidators, and determine their powers.

Thus, in the Court's view, at least in some procedural respects, voluntary liquidation has even less in common with insolvency than winding-up by the court. Therefore, the reasons which had led the Court to hold in *Déthier Équipement* that the Directive was to apply to transfers occurring when an undertaking was wound-up by the court were all the more pertinent when the undertaking transferred was wound-up voluntarily.

²⁴ Case C-399/96 *Europièces SA, in liquidation v Wilfried Sanders and Automotive Industries Holding Company SA, declared insolvent* [1998] ECR I-6965.

In light of the foregoing, the ECJ reached the conclusion that the Directive applied to the transfer of a business made by a company in voluntary liquidation, under the relevant Belgian law.

2.3 The approach of the ECJ

There was little consensus after the ECJ judgments. The approach of the ECJ in *Abels* has been described as “ultimately unsatisfactory and even incoherent”²⁵.

The reasoning behind ECJ’s conclusion has been considered “rather weak”²⁶. Since the Court has accepted that uncertainty exists regarding the effect of the application of the Directive in the case of an employer’s insolvency, there must be a risk that the Court, contrary to the Treaty, is depriving of protection those most in need of it.

The difference drawn by the Court between pre-liquidation and liquidation proceedings has been considered inadequate²⁷. The argument for not applying the Directive to liquidation is that it might dissuade a potential transferee from acquiring an undertaking and lead to the sale of the assets of the undertaking on a break-up basis. However, the choice between the sale of the business as a going concern and on a break-up basis lies with the insolvency practitioner. It does not arise only when the company is put into liquidation. Insolvency practitioners will choose the method that most benefits the creditors, whether the company is in liquidation or in the context of pre-insolvency proceedings. Therefore, it is difficult to understand why the argument for exemption from the Directive does not apply equally to pre-liquidation proceedings. In addition, the “protectionist” line adopted by the Court has generated much criticism among the academic writers of the Member States²⁸.

The Directive aimed to balance employment protectionism with commercial realism. Through the many references for preliminary rulings which have come before it from the national courts, the European Court of Justice has ensured that this balance is weighted in favor of the protection of employees’ rights. The expansive approach pursued by the Court of Justice has effectively

²⁵Davies, Paul, “Acquired Rights, Creditors’ Rights, Freedom of Contract and Industrial Democracy”, (1989) 9 YEL 21 at 45.

²⁶ Davies, Paul, *op. cit.*, n. 24 at 46.

²⁷ *Ibid.*

²⁸ See Chapters III and IV.

resulted in a situation where a Directive designed in part to facilitate the transfer of business²⁹ has acted as a deterrent to such transfers.

Finally, the expansive jurisprudence of the ECJ has also been considered as conflicting with the current employment policy commitments, which have emphasized the need for labor flexibility³⁰.

3. Business transfers and corporate insolvency in the UK

3.1 Prior national law and the implementation of the Acquired Rights Directive in the UK

The Transfer of Undertakings (Protection of Employment) Regulations 1981 (hereinafter referred to as “TUPE” Regulations) constitute the UK domestic legislation implementing the Acquired Rights Directive. Regulations 5(1) and (3) provide that, following a “relevant transfer”³¹, all of the transferor’s rights, powers, duties, and liabilities under or connected to any contract of employment of any person employed in the undertaking “immediately before” the transfer will be inherited by the transferee. Regulation 8(1) provides that dismissals in connection with the transfer are automatically unfair, unless they are for an “economic, technical or organisational reason entailing changes in the workforce” (hereinafter referred to as “ETO” reason). In this case, Regulation 8(2) deems them to be dismissals for a substantial reason in the context of the ordinary law of unfair dismissal.

Unlike the position in Italy - where the principle of the compulsory transfer of contracts of employment upon the transfer of a business was a long-established part of the national labor law dating even from the pre-war period - in the UK, the pre-Directive law had always been based on the principle of freedom of contract and, in particular, the freedom to choose one’s contracting party. Upon the transfer of a business, the transferee was free to offer employment to members of the transferor’s staff as it pleased and on such terms as it thought fit. The employees of the transferor to whom offers of employ-

²⁹ See Section 1.1 above

³⁰ See e.g. the Commission’s 1993 White Paper, *Growth, Competitiveness, Employment: The Challenges and Ways Forward into the 21st Century* Bull EC, Supp. 6/93; COM (93) 700.

³¹ It is defined in Reg. 3 (1) as a “transfer from one person to another of an undertaking ... or part of one”.

ment were made were equally free to accept them or not. Therefore, in the UK, the Directive's principle of the compulsory transfer of contracts of employment and the associated principle that dismissals for reasons connected with the transfer were ineffective had profound impacts, particularly in the case of insolvent companies.

3.2 Insolvent companies and TUPE

An insolvency practitioner will commonly decide that it is in the interest of the insolvency proceedings for the existing business of the insolvent employer company to be transferred as a going concern. Such a transfer can either be:

- a) by way of a disposal of the business to an unconnected third party, or alternatively,
- b) by way of a “hive-down” of the business from the insolvent employer company to a subsidiary company newly formed for this purpose.

The transfer of a business, whether to a third party or by way of a “hive-down”, will usually constitute a transfer of an undertaking within the scope of the TUPE Regulations.

The TUPE Regulations do not expressly provide for the exclusion of transfers made by insolvent companies. Regulation 4 (concerning “hive-down”) is, instead, an indication that TUPE Regulations are intended to apply to insolvent companies. Moreover, Regulation 3(2) provides that the Regulations apply *“whether the transfer is affected by a sale or by some other disposition or by operation of law”*. These words gave rise to the possible interpretation that the Regulations could apply to all insolvency/liquidation situations. Regulation 3(2) can be considered as a more favorable provision for employees introduced by national law pursuant to Art. 7 of the Directive³².

³² However, there may be some doubt as to whether the TUPE Regulations could introduce provisions more favorable to employees within the meaning of Article 7 of the Directive. The TUPE Regulations were, in fact, introduced by a statutory instrument under the special provision of s. 2(2) of the European Communities Act 1972, rather than by a formal Act of Parliament. The question is whether legislation under s. 2 (2) of the European Communities Act must be specifically directed to the implementation of the European obligation or whether it may go further. The Employment Appeal Tribunal (“EAT”) in Scotland, in *Addison v Denholm Ship Management (UK) Ltd* ([1997] ICR 770, [1997] IRLR 389, EAT), stated that “as a matter of general law in relation to primary and subordinate legislation (...) if the Directive is to be regarded as a parent, the child cannot be larger, wider or have greater implications than its parent allows”.

In *Addison v Denholm*, the EAT also stated that if the effect of the TUPE Regulations is “to confer a lesser exclusion, and less wider benefit, to workers otherwise excluded by the Directive” it can be considered “ultra vires the ena-

However, TUPE Regulations were enacted to implement the Acquired Rights Directive. In the Directive, there is no express exemption for transfers of undertakings in the context of insolvency proceedings. The ECJ attempted to define the scope of the Directive in this regard. In *Abels*, it ruled that the Acquired Rights Directive does not apply to transfers “*where the transferor has been adjudged insolvent and the undertaking or business in question forms part of the asset of the insolvent transferor*”. When the proceedings in question aim to safeguard the assets of the undertaking, in view of continuing trade, the Directive does apply. Therefore, British courts had to decide how the principles developed in the judgments of the ECJ were to be applied in the context of domestic insolvency proceedings.

3.3 Which UK insolvency proceedings are outside the scope of the Acquired Rights Directive and TUPE Regulations?

An in-depth analysis of the insolvency regime in the UK is beyond the scope of this dissertation. However, a brief description of the insolvency regime follows.

The statutory insolvency regime in England and Wales was largely consolidated in the *Insolvency Act* 1986 (IA 1986) and the accompanying statutory instruments. Broadly speaking, insolvency situations can be divided into liquidation and alternatives to liquidation. There are three types of liquidation (compulsory liquidation, members’ voluntary liquidation, and creditors’ voluntary liquidation) and three alternatives to liquidation (voluntary arrangement, administration, and administrative receivership).

3.3.1 Liquidations

Liquidation involves the termination of the existence of a company. Such a termination can occur when the company is solvent or may be required because the company is insolvent. Liquidation may either be voluntary or required by the court.

bling power and would require primary legislation as contemplated by Article 7 of the Directive”. The contrary argument that the following legislation amending TUPE (Trade Union Reform and Employment Rights Act 1993) would have confirmed the statutory authority of all the provision of TUPE itself is not entirely convincing. See also the approach of the House of Lord in interpreting Regulation 4 in *Litster v Forth Dry Dock & Engineering Co Ltd*, ([1990] 1 AC 546) discussed below.

*a) Court liquidations*³³

Such a type of liquidation requires an application to the court for a winding-up petition³⁴. The application may be submitted by various parties (usually either by the company, the directors, or by a creditor) in the following cases³⁵:

- when a special resolution has been passed by the members of the company that the company be wound-up by the court;
- when the company is unable to pay its debts; and
- when the winding-up is “just and equitable”.

After the presentation of a winding-up petition, the court may appoint a provisional liquidator who will usually take over the management of the company pending the winding-up order.

*b) Voluntary liquidation*³⁶

Such kind of liquidation requires a shareholder’s resolution to the effect that the company cannot continue its business by reason of its liabilities and that it is advisable to wind-up³⁷.

A voluntary liquidation may be either a members’ voluntary winding-up or a creditors’ voluntary winding-up. In members’ voluntary winding-up, control of the winding-up (including the right to appoint a liquidator) remains with the shareholders. In creditors’ voluntary winding-up, control passes to the creditor (including the right to override appointment of a liquidator by the members and appointment of a liquidation committee to oversee the liquidator).

A voluntary winding-up is a creditors’ voluntary winding-up unless a declaration of solvency has been sworn by the directors and filed with the Companies Registry³⁸. A members’ voluntary winding-up may be converted to a creditors’ winding-up if it later becomes apparent that the company is insolvent³⁹.

In both judicial and voluntary proceedings, the essence of insolvent liquidation is that the assets of the company are realized by the liquidator and distributed among the creditors. The company will cease to carry on business from the date of the winding-up order or resolution. The liquidator will collect the

³³ Court liquidations are governed by Chapter VI of Part IV of the IA 1986.

³⁴ IA 1986, s 124.

³⁵ IA 1986, s 122 (1).

³⁶ Voluntary liquidations are governed by Chapters II to IV of Part VI of the IA 1986.

³⁷ Under IA 1986, s 84, the resolution can be a special resolution, an extraordinary resolution, or an ordinary resolution (only if there is a special provision in the Articles of Association to that extent).

³⁸ IA 1986, ss 89, 90.

³⁹ IA 1986, ss 95, 96.

assets of the company (which will not include assets subject to fixed or floating charges); creditors will prove the amount of their debts as of the time of the winding-up order or resolution, and the liquidator will realize the assets and distribute them following a certain prescribed order.

Bearing in mind the judgments of the ECJ, the court liquidation of a company based on insolvency will be within the terms of *Abels* and hence outside the Acquired Rights Directive. There may be some doubt regarding whether a winding-up order is made when there is no insolvency (e.g. on the just and equitable ground in s 122.1 (g) of the IA 1986)⁴⁰.

With regard to voluntary liquidation, there may be doubt as to whether the Acquired Rights Directive (and hence the TUPE Regulations) applies when the transferor is in a creditors' voluntary liquidation even in the absence of a court order. In that case, the transferor company, although it has not been "*adjudged insolvent*", is, in fact, insolvent. Following the reasoning of the ECJ in *D'Urso*, the lack of judicial determination to that effect would seem irrelevant. Conversely, it seems clear that the Directive (and therefore the TUPE Regulations) will apply when the transferor is in a members' voluntary liquidation. In this case, the company is solvent⁴¹ and the reasons for excluding the transfer of the undertaking from the scope of the Directive do not apply. The *Dethier* and the *Europieces* decisions support that conclusion. In *Dethier*, the ECJ held that the Directive applied in the case of a Belgian company being wound-up by the court in circumstances where the company continued to trade and was not subject to insolvency proceedings. In *Europieces*, the ECJ held the Directive applicable in the case of a Belgian voluntary liquidation voted upon by shareholders.

3.3.2 Alternatives to liquidation

The three alternatives to liquidation are voluntary arrangement, administration, and administrative receivership.

⁴⁰ In *Charlton v Charlton Thermosystem Ltd* [1995] ICR 56 at 64 the EAT referred to *Abels* and held that TUPE applied to a transfer from a dissolved company which had been struck off by the Registrar of Companies without any judicial proceedings.

⁴¹ The directors have to swear a statutory declaration of solvency and file it with the Companies Registry (sec. 89 and 90 Insolvency Act 1986).

a) *Voluntary arrangement*

This procedure was introduced in 1986⁴². A proposal must be submitted by the directors, a liquidator, or an administrator to a nominee. If the nominee agrees with the proposal, he will first file a copy with the court and then will call a meeting of the shareholders and creditors. If, during the meeting, the proposal is approved, it will bind each person who received notice of the meetings and was entitled to vote⁴³. A supervisor will be appointed to carry out the voluntary arrangement.

Clearly, this procedure does not have the characteristics of liquidation proceedings. Consequently, it must be considered as falling within the scope of the Directive and TUPE Regulations.

b) *Administration*

This is a new procedure introduced in 1986, and was designed to aid in the rescue of companies avoiding liquidation when possible⁴⁴. It is a mechanism used to freeze the enforcement of security or presentation of winding-up petition. Its purpose is to give the company space for further negotiations to see if the business can be saved without winding-up the company.

It applies to companies which are, or are likely to become, unable to pay their debts. A creditor or, more commonly, the directors of the company will present a petition to the court. The court can appoint an administrator to take over the management of the company. The purposes of administration include the survival of the company as a going concern and the more advantageous realization of the company's assets than in a winding-up.

Administration is only a temporary measure. If it succeeds, the company will be returned as a going concern or it will be followed by an arrangement with creditors, including a voluntary arrangement. Otherwise, the company will enter liquidation.

Administration is perhaps similar to the Dutch "*surseance van betaling*" (or judicial leave to suspend payment of debts), which the ECJ, in *Abels*, held did not exempt a transfer from the Directive. However, following the ECJ decisions in *D'Urso*, *Spano*, and *Detthier*, it seems that any administration whose purpose in-

⁴² The procedure is set out in Part I of the IA 1986 and Part I of the Insolvency Rules 1986.

⁴³ However, the court may overturn the proposal if it is challenged within 28 days by a creditor claiming that it will be unfairly prejudiced or that there has been a material irregularity (IA 1986, s. 6). The proposal must contain savings for the position of unsecured creditors (IA 1986, s 4 (3)) and preferential creditors (IA 1986, s 4 (4)).

⁴⁴ Administration is governed by IA 1986, ss 8-27 and Insolvency Rules 1986 Pt. 2.

cludes the seeking of the survival of a business (i.e. for a purpose within s 9 (1) (a), (b) or (c) of the Insolvency Act 1986) will be within the Directive. An administration for the sole purpose of the more advantageous realization of the company's assets that would be effected on a winding-up (i.e. within s 9 (1) (d) of the Insolvency Act 1986) may be outside the Directive.

c) Administrative Receivership

An administrative receivership is a special type of contractual receiver appointed in relation to a company under a floating charge⁴⁵. A contractual receivership is a contractual device included within security documents (usually fixed and floating charges)⁴⁶. It enables the security holder – without the need for a court order – to appoint a receiver. The receiver will receive income and take charge of the management of the company which has given the security. It is a means of realization and enforcement of the security.

A contractual receiver is an administrative receiver if the debenture holder who appointed him had a floating charge over the whole, or substantially the whole, of the company's undertaking.

The main purpose of the receiver is to recover the relevant secured amount. An administrative receiver typically seeks to sell part or all of the business as a going concern to a transferee. The transfer of assets as elements of a going concern in the context of such proceedings has to be distinguished from the transfer of assets as separate assets in the course of a liquidation proceeding. Such a difference has been pointed out by the Advocate General in *D'Urso* and *Spijkers v Gebroeders Benedik Abattoir*⁴⁷. The transfer of assets as a going concern enables the undertaking's business to be maintained as long as possible. In this case, the TUPE Regulations – which must be construed in accordance with the Directive as interpreted by the ECJ – will apply to any eventual outside purchaser. This is to the detriment of the charge holder and other creditors since the receiver, because of the automatic transfers of accrued liabilities, will probably realize less on the sale of the business.

⁴⁵ See the definition in IA 1986, s. 29 (2).

⁴⁶ IA 1986, ss 33-41.

⁴⁷ Case C- 24/85 [1986] ECR 1119.

3.4 “Hiving-down”

“Hiving-down” is a process by which a liquidator, administrative receiver, or administrator can seek to attract a purchaser for the insolvent business and to facilitate the sale of the company’s undertaking. It involves the set up of new wholly-owned subsidiary of the insolvent parent company and the transfer of the ownership of the business (or the salvageable parts of it) to the subsidiary, while retaining employees in the employment of the parent company. The business of the subsidiary will be staffed by the same employees by means of labor supply agreements. The subsidiary will agree to pay its parents a cash sum for the business, but such sum will be specified under a supplemental agreement and will become payable on demand by the parent company. However, the parent company will not demand payment of the cash consideration until the subsidiary is purchased by an outside buyer. The purchaser, if one is found, will either buy the issued shares from the parent company or will take a transfer of the business from the wholly-owned subsidiary. Shortly before the acquisition of the wholly-owned subsidiary’s business by the outside purchaser⁴⁸, the insolvency practitioner will have dismissed the employees of the parent company. In the event that no purchaser is found, the company will be liquidated and the entire workforce dismissed on account of redundancy.

The advantage of this process is that the receiver is able to offer the subsidiary’s business for sale as a clean package, free of encumbrances such as any financial claims by the workforce and without prejudice to the purchaser’s right to choose which employees (if any) he cares to re-employ. All liabilities are inherited neither by the subsidiary nor, on its eventual sale, by the outside purchaser. They remain with the insolvent parent company.

According to the insolvency practitioners, the application of TUPE Regulation 5 to the process of “hiving-down” would have detrimental effects. As a consequence of such application, the employees would be automatically transferred along with the business to the subsidiary company. Any liability for subsequent dismissal would then have to be borne by the subsidiary unless the subsidiary was sold. In this case, the purchaser would have acquired the liabili-

⁴⁸ Dismissals might also occur before the acquisition of the subsidiary when the latter does not need the parent company’s employees to carry on its business.

ties arising from the dismissal of employees before the sale of the subsidiary. In response to insolvency practitioners' representations, the Government enacted TUPE Regulation 4.

Regulation 4 provides that, when a relevant transfer is made by an insolvency practitioner to a wholly owned subsidiary of the insolvent company, the transfer of employment liabilities, under Regulation 5, from the insolvent company to the wholly-owned subsidiary does not take place on the transfer. It is postponed until either the wholly-owned subsidiary (i) ceases to be a wholly-owned subsidiary of the insolvent company, or (ii) the relevant undertaking is transferred by the wholly-owned subsidiary to another person.

The reason for such provision obviously was to give the insolvency practitioner more time to arrange for dismissal of some or all of the employees before the ultimate sale to a third party took place. As long as the insolvency practitioner dismissed employees before the disposition of the business to the outside purchaser and made sure that the effective date of termination of these employees was before the disposition of the business, the purchaser could acquire the business free of employees. Liabilities to the dismissed employees would remain as liabilities of the insolvent company rather than being passed on to the purchaser.

The process of "hiving-down" was common in insolvency proceedings until the late 1980s. After the introduction of the TUPE Regulations, it has been allowed by a narrow interpretation of the Regulations themselves. Regulation 3 (1) provides for the compulsory transfer of those employed by the transferor "*immediately before the transfer*". It was argued that those who were dismissed by the transferor before the transfer took place would not be caught by this rule, even if the dismissal preceded the transfer by only a matter of hours.

The leading case became *Secretary of State v Spence*⁴⁹ in which the Court of Appeal appeared to hold that employees dismissed at 11 am were not transferred in a transfer which occurred at 3 pm on the same day. This interpretation of the Regulations rendered compliance with its obligation "voluntary"⁵⁰ and provided strong economic incentives for the transferee to arrange with the

⁴⁹ [1986] ICR 651 (CA).

⁵⁰ Davies, Paul "Amendments to the Acquired Rights Directive", (1988) 17 ILJ 249 at 250.

transferor to carry out such dismissals in order to avoid or reduce costs associated with compensation for unfair dismissal and redundancy⁵¹.

The decision of the House of Lords in *Litster v Forth Dry Dock*⁵² has so severely restricted the scope for dismissals prior to the sale of a hived-down subsidiary as to undermine the commercial usefulness of the hiving-down practice. In this case, the House of Lords expressed a willingness to depart from the strict letter of the domestic Regulations in order to comply with the purpose of the Directive and the interpretation placed upon it by the European Court of Justice. Since the defendant in the *Litster* case was not an organ of the State, the employees could not, in light of *Marshall*⁵³, rely upon the horizontal direct effect of the Directive. Consequently, the House of Lords' approach was based upon the interpretation of UK law in light of the European law rather than directly upon community law. The Court held that "if the legislation can reasonably be construed so as to conform with those [European Community] obligations – obligations which are to be ascertained not only from the wording of the relevant Directive but from the interpretation placed upon it by the European Court of Justice at Luxembourg – such a purposive construction will be applied even though, perhaps, it may involve some departure from the strict and literal application of the words which the legislature has elected to use."⁵⁴

The House of Lords, departing from its traditional approach, held that community case law should control the implementation of the Directive in the UK, even where it meant a substantial addition to the words of the implementing legislation enacted by the British Parliament. As Lord Oliver said in *Litster*, it is not "conceivable that, in framing Regulations intending to give effect to the Directive, the Secretary of State could have envisaged that its purpose should be capable of being avoided by the transparent device to which resort was had in the instant case."⁵⁵

The House of Lords closely examined Article 4 of the Directive⁵⁶. It also referred to a number of decisions of the ECJ, of which undoubtedly the most

⁵¹ Collins, Hugh "Transfer of Undertakings and Insolvency" (1986) 15 ILJ 144 at 150.

⁵² [1990] 1 AC 546.

⁵³ C-152/84 *Marshall v. Southwest Hampshire AHA* [1986] 1 CMLR 688.

⁵⁴ [1990] 1 AC 546 at 559, per Lord Oliver.

⁵⁵ [1990] 1 AC 546 at 576, per Lord Oliver.

⁵⁶ Article 4 of the Directive corresponds approximately to Regulation 8 and states that "the transfer of an undertaking, business or part of business shall not in itself constitute grounds for dismissal by the transferor or the transferee".

important was *Borke*⁵⁷. In that judgment, the ECJ held that “workers employed by the undertaking whose contract of employment or employment relationship has been terminated with effect on a date before that of the transfer, in breach of Art. 4(1) of the Directive, must be considered as still employed by the undertaking on the date of the transfer with the consequence, in particular, that the obligations of an employer towards them are fully transferred from the transferor to the transferee, in accordance with Article 3 (1) of the Directive”⁵⁸.

On the basis of the foregoing, it was clear that the previous interpretation of “immediately before” by the UK courts was inconsistent with the case law of the ECJ. The House of Lords accepted that Article 4 of the Directive imposes a mandatory obligation on Member States and held that, for the purpose of Regulation 8(1), the phrase “employed immediately before the transfer” had to be construed to include employees who would have been so employed at the time of the transfer “if they had not been unfairly dismissed in the circumstances described in Regulation 8(1)”. This means that if an employee is dismissed prior to a transfer for a reason connected with it, he or she will be deemed to have been employed “immediately before the transfer”; the contract will be automatically transferred to the transferee and the latter will be liable for unfair dismissal. It is the motive for the dismissal, not the precise timing, which is important for the application of TUPE Regulations.

By this decision, the House of Lords intended to restore the force of the Regulations by increasing the opportunities for claims against the transferee. It believed – no doubt correctly – that in many instances leaving the employees

⁵⁷ Case C-101/87 [1988] ECR 3057 at 3071.

⁵⁸ However, in *Lister*, the House of Lords held that only pecuniary obligations with respect to the dismissed employees were transferred to the transferee, not that the employment relationship persisted as if no dismissal had taken place at all. The approach in *Lister* might be inconsistent with the ECJ decision in *Borke* but it is not inconsistent with the wording of Art. 4 of the Directive, which states that the transfer should not constitute grounds for dismissal, rather than considering the dismissal without effect. Moreover, in *Borke*, the ECJ had accepted that national law must establish whether a contract of employment exists. Later on, in *Wilson v St Helen's Borough Council and Meade and Baxendale v British Fuels Limited* ([1997] IRLR 505), the Court of Appeal (referring to *Meade* case) held that when an employee was dismissed for a reason connected principally with the transfer, the dismissal was a nullity and the employee continued to be employed under the terms of the original contract. Therefore, subsequent variations to the terms and conditions of employment were unlawful. On the contrary, where (as in *Wilson*) dismissals were justified by an ETO reason, the contracts of employment did not continue and the transferee was entitled to re-employ the staff on different terms and conditions. This pronouncement led to the bizarre result that it was not possible to know whether a dismissal was effective until a tribunal decided what had caused the dismissal. The cases, however, were appealed to the House of Lords ([1998] IRLR 706) which clarified that a dismissal, even if connected with the transfer, will be effective. However, it will be automatically unfair if it is not for an ETO reason.

with claims solely against the transferor would prove worthless because of the transferor's insolvency⁵⁹.

Only where dismissals prior to the transfer are motivated by reasons independent of the transfer – such as closure of the business by reason of insolvency without an immediate prospect of resale⁶⁰ or because of the absence of any work to be performed by employees⁶¹ – the application of Regulation 5 will be avoided and no claims against the transferee will be permitted.

Regulation 8(1) provides that dismissals in connection with the transfer are automatically unfair, unless they are for an “*economic, technical or organisational reason entailing changes in the workforce*” (“ETO” reason). Applying the ratio of the *Litster* decision in the context of insolvency proceedings, Regulation 5 will cover dismissals of employees during a hiving-down unless the dismissals are for an ETO reason⁶². In light of *Litster*, the importance of the ETO exceptions in Regulation 8(2) is considerably enhanced⁶³.

3.5 The ETO exception

Regulation 8 (2) exempts employers from the rule of automatic unfair dismissals when the dismissals occurred for an economic, technical, or organizational reason. In the context of insolvency proceedings, do dismissals intended to facilitate the prospect of a sale of the business count as an economic reason within Regulation 8(2)?

⁵⁹ Collins, Hugh *op. cit.*, n. 50 at 146.

⁶⁰ Case C-19/83 *Wendleboe v L.J. Music ApS* ECR 457.

⁶¹ As in *Secretary of State v. Spence* [1986] ICR 651 (CA).

⁶² Applying the rulings in *Tsangacos v Amalgamated Chemicals Ltd* ([1997] ICR 154), the EAT held that the transferee did not take over the liability of the transferor to an employee who had been dismissed four months before the transfer for a reason not connected with the transfer.

⁶³ It has to be noted that in *Spano* (see Chap. I), the ECJ dealt with a process described as a “technical reorganisation” but very similar to that involved in hiving-down. In fact the company transferred part of the enterprise to a new company, leaving the “surplus” staff with the old entity, which was then judged to be in financial difficulty. In all, 600 staff moved and 755 were left behind. It was argued that the remaining company, declared to be in a critical financial state under Italian law, was outside the scope of the Directive because of the decision in *Abels* (see Chap. I). This argument failed in this case because, under Italian law, the purpose of declaring a business to be in critical financial difficulties is normally a step in the direction of trying to rescue the business, in which case the Directive would apply. The Court failed to make any judgements on the wider issue of stripping out the profitable parts of a business with the intention of avoiding the effect of the Directive.

Such a result occurred in *Anderson v Dalkeith Engineering Ltd*⁶⁴, where the EAT held that pre-transfer dismissals made at the request of the prospective purchaser were for an economic reason and hence within Regulation 8(2). However this line of authority was subsequently disapproved by the EAT. In *Wheeler v Patel*⁶⁵, for instance, the EAT decided that only economic reasons “*which relate to the conduct of business*” rather than its sale or transfer satisfy Regulation 8(2). A desire to achieve a sale or an enhanced price is not enough. This line of authority has also been followed by the Northern Ireland Court of Appeal in *Willis v McLaughlin & Harvey plc*⁶⁶.

A difference should be drawn between various situations in which dismissals occur.

a) Dismissal followed by an unexpected transfer of the business

The insolvency practitioner may decide that a sale of business of the company is not likely and, accordingly, decide to dismiss an employee. If a subsequent transfer occurs, it is unlikely that the dismissal would be deemed to be connected with the transfer⁶⁷.

b) Dismissal on demand of the potential purchaser already identified

An insolvency practitioner may decide to dismiss one or more employees because the potential purchaser so requested. Such a collusive dismissal will, almost inevitably, be considered to be connected with the subsequent transfer. An authority for that can be found in *Litster* itself as well as in *Harrison Bowden Ltd v Bowden*⁶⁸.

⁶⁴ [1984] IRLR 429.

⁶⁵ [1987] ICR 631.

⁶⁶ [1998] EuRL 22.

⁶⁷ See *Spence* case [1986] ICR 651 (CA).

⁶⁸ [1994] ICR 186. Mr Bowden was dismissed by the receiver on a Thursday (31 January) and subsequently re-employed the following Monday (4 February) in preparation for the transfer which took place the following Friday (8 February). He was then dismissed by the transferee shortly after. The industrial tribunal held that the dismissal by the receiver was connected with the transfer. Indeed, the applicant had been dismissed to make the company more transferrable and/or transferred at a better price. Therefore, the dismissal was in direct connection with the transfer of the business. In the Tribunal's view, the receiver did not dismiss the applicant because he simply could not afford to have the staff and then at some later date, long after the dismissal, an approach was made to buy the business. Instead, the dismissal and transfer were strictly connected the one to the other. At the following stage, the EAT rejected the argument raised by the transferee on appeal that no specific transferee had been identified by the receiver, and the EAT referred to the ECJ judgement in *Bork* where no prospective transferee had been identified at the time of the dismissal. In *Longden and Paisley v Ferrari Limited* [1994] IRLR, 157 the EAT refused to overrule the decision of the industrial tribunal that various employees were dismissed because of pressure on the receivers by the bank and not because of the proposed transfer. This was despite the fact that the purchaser had given the receivers a list of essential staff. A list of employees to be retained was held not to amount to a request from the transferee to dismiss the others.

However, it cannot be said that a pre-transfer dismissal on demand or with the consent of the potential purchaser will never be for an ETO reason. Of course, it will be very difficult (if not impossible) to establish an ETO reason when the transferee subsequently re-employs the dismissed employees in the same job as before (as in *Harrison Bowden*), hires new employees, or redirects its existing employees into the business. Nevertheless, the transferred business might really require fewer employees so that the employees dismissed before the transfer were genuinely redundant. This should be a valid ETO reason. As the Northern Ireland Court of Appeal recognized in *Willis v McLaughlin & Harvey plc*⁶⁹, referring to the EAT decision in *Wheeler v Patel*⁷⁰, a dismissal at the request of a purchaser can be for an ETO reason “if it can be shown that the prospective purchaser would not proceed unless the employee was dismissed. In those circumstances, it may be said that the employee is dismissed to enhance the prospects of the sale of the undertaking, but since this is necessary for the sale to proceed and the business could not otherwise survive, it is an economic reason which entails a change in the workforce”. This line of authority has also been followed in *Whitehouse v Blatchford & Sons Ltd*⁷¹, where the transferee had taken on the employees concerned and then dismissed one of them. Following the ECJ decision in *Dethier, Warner v. Adnet*⁷², it was confirmed that a transferor may lawfully dismiss an employee for an ETO reason.

c) Dismissals to make business more attractive to potential purchaser not yet identified

The situation is more problematic when dismissals occur to make a business attractive to a potential purchaser not already identified (or, similarly, to make a business more efficient in view of trading out of insolvency or possible sale).

An insolvency practitioner – acting in the interest of the insolvent company itself – will often seek, at some stage, to sell the company’s business as a going concern. He might reasonably consider that the business would be more attrac-

⁶⁹ [1998] EuLR 22.

⁷⁰ [1987] IRLR 211.

⁷¹ [1999] IRLR 492. In this case a new contractor for hospital services took over the existing employees under TUPE, but then had to make one redundant because the hospital stipulated that fewer numbers of technicians were needed. The Court of Appeal held that this was an ETO reason.

⁷² [1998] IRLR 394. In this case the administrative receivers of Adnet made Mr. Warner redundant before the sale as a going concern of Adnet. The Court of Appeal agreed with the industrial tribunal decision that the principal reason behind Mr Warner’s dismissal was an ETO one and that the dismissal was not unfair. See also *Kerry Foods Ltd v Creber* [2000] IRLR 10.

tive to a purchaser with a slimmed down workforce. Accordingly, he will make various dismissals in the preparatory stage.

Two arguments may be raised to argue that a dismissal at this stage is not within the scope of Regulation 8 (1) of TUPE:

- the dismissals will form part of a general restructuring by the insolvency practitioner not only for the prospect of a transfer;
- the dismissal is not connected with an identified purchaser. Regulation 8 provides that an “employee shall be treated ... as unfairly dismissed if the transfer or a reason connected with it is the reason or the principle reason for the dismissal”. When the purchaser is not yet identified, the dismissal may be connected with a possible transfer, but it is not connected with the ultimate transfer.

However, the wording of TUPE requires that the transfer (or a reason connected with it) is the only or principal reason for the dismissal. Therefore, the first argument raises a subjective difficulty since it is necessary to establish what was in the mind of the insolvency practitioner at the time of dismissal (the transfer of the business or the restructuring?).

With regard to the second argument, it has to be noted that Article 4 (1) of the Acquired Rights Directive is clearer than Regulation 8 in providing that “*the transfer of an undertaking, business or part of a business shall not in itself constitute grounds for dismissal by the transferor or the transferee*”. This wording seems to be clearer in providing that the dismissal can be connected with any transfer, not just a specific identified transfer⁷³.

It is also difficult to find any guidance in the case law. The second argument above was rejected by the EAT in *Harrison Bowden* but was accepted by a later EAT decision in *Ibex Trading v Walton*⁷⁴. In *Parmar v Ferranti International plc*⁷⁵, the EAT followed *Ibex*. In some other cases (as in *Morris v John Grose Group Ltd*⁷⁶), the EAT followed *Harrison Bowden* and not *Ibex*.

⁷³ Pollard, David “Insolvent companies and TUPE”, (1996) 25 (3) *ILJ*, 191 at 202.

⁷⁴ [1994] IRLR 564. In this case, unusually, by the time it reached the EAT, the employees had decided that the transferor had more assets than the purchaser. Correspondingly, they argued that liability had not passed to the transferee. The EAT upheld the decision of the tribunal that the transferor remained liable because the dismissals were not for a reason connected with the transfer.

⁷⁵ [1997] 13 March (EAT 710/96)

⁷⁶ [1998] ICR 655. In this case, the EAT found that the words “the transfer” in Regulation 8 (1) could perfectly well mean “transfer” or “a transfer” and that the tribunal had erred in attaching significance to the definitive article.

It seems that the ETO exception has been construed narrowly by the courts. Dismissals will probably be connected with the transfer, even if they occur before negotiations have started with any potential purchaser. To avoid such a consequence, it should be shown that the principal reason was not to make the business more attractive for potential purchasers but, for instance, because the insolvency practitioner could not afford to keep the staff on. However, it is likely that the insolvency practitioner will have more than one reason to dismiss employees and the potential purchaser will not be able to identify the principal reason for any dismissal.

3.6 The balance between the acquired rights of employees and the interests of other creditors

The analysis of the Regulations on the transfer of undertakings and insolvency in the United Kingdom has raised a complex interaction between the interests of the employees and the interests of other creditors.

Shortly after the adoption of the Directive, there was a clear perception of the existence of a number of problems in applying the Acquired Rights Directive and TUPE Regulations to insolvency situations. The essence of insolvency proceedings is that the assets of the company are realized and distributed among the creditors of the company. Creditors may fall into various classes with some priorities among them in the satisfaction of their claims. The consequence of the application of the principle of compulsory transfer of employment relationships is that the employees are treated more favorably than all other creditors because there is no risk of their claims not being met in full.

Only with regard to “hiving-down”, in the possible clash between the interests of the company’s creditors and the employees’ acquired rights, was absolute priority granted to the former. There was no attempt to produce even a compromise between the two claims. Even if hiving-down would involve dismissal, selective re-engagement, and an eventual modification of terms of employment of those re-engaged, it would at least create some new jobs. A purchaser would not be attracted to the purchase if he had to take on all the work force and could not modify the terms and conditions of engagement. This, of

course, is at the expense of the employees' rights under the Acquired Rights Directive.

In all other situations, British courts following the ECJ ensured that the balance between the two opposite interests was weighed in favor of protecting employees' rights. However, in their evidence presented to the House of Lords Committee investigating changes to the Directive, the Society of Practitioners of Insolvency considered the transfer of undertakings legislation as "an impediment to the rescue of businesses in the context of formal insolvency". In view of the Practitioners, the above legislation had "the opposite from its intended effect of preserving employment and employee's rights". The Practitioners cited numerous examples of cases "where the prospect of taking over accrued liabilities under employment contracts had either deterred prospective purchasers of insolvent businesses from dealing altogether, or had caused them to discount the price which they were prepared to pay"⁷⁷.

The protectionist approach of the ECJ also led British courts to narrowly interpret the ETO exception. As Pollard ⁷⁸ noted, it might seem surprising that insolvency itself has not often been considered as a situation giving economic, technical, and organizational reasons justifying a change in the workforce. The narrow interpretation of the ETO exception is one of the reasons for the cautious approach of insolvency practitioners. A prospective purchaser would not take the risk of invoking the ETO exception. Rather, the insolvency practitioners will be very cautious and will reduce the workforce as much as possible before discussions and negotiations commence with prospective purchasers.

Such an approach leads to a surprising result. As it has been pointed out, "the desire to reduce the risk of a connection with any subsequent transfer may well mean that insolvency practitioners tend to make dismissals at an earlier stage than they would otherwise. It is ironic that, if this occurs, the effect of the protective provision in TUPE will have been to reduce job security"⁷⁹.

As Pollard ⁸⁰ concluded in 1996, the balance between the interest of employees and other creditors of the company has not yet been satisfactorily

⁷⁷ Select Committee on the European Communities, Session 1995-96, 5th Report.

⁷⁸ Pollard, David, *op. cit.*, n. 72 at 209.

⁷⁹ Pollard, David *op. cit.*, n. 72 at 202.

⁸⁰ Pollard, David *op. cit.*, n. 72 at 210.

struck and uncertainty could be seen as “tending to both earlier dismissals and less prospect of protecting jobs by way of successful business sale”.

4. Business transfer and corporate insolvency in Italy

4.1 Prior national law and the implementation of the Acquired Rights Directive in Italy.

In Italy, the principle of the compulsory transfer of contracts of employment upon the transfer of a business was established in 1942 under Article 2112 of the Civil Code.

The original version of Article 2112 was introduced as a special provision, derogating from the general principle of freedom of contract, with the purpose of protecting employees considered to be in a less favorable position (from economic and social points of view) with respect to the employer. The compulsory transfer of contracts of employment upon the transfer was excluded “where the transferor had given the required notice” and employees were only entitled to retain “the rights arising from the seniority acquired before the transfer”.

During the Italian economic crisis (1975-1980), the above regulation introduced by Article 2112 appeared to be too rigid. On the one hand, Italian courts held collective agreements, partially derogating from the principle of compulsory transfer of employment relationship, effective. On the other hand, the Italian legislator attempted through various legislative initiatives to give priority to the need to ensure – as far as possible – the rescue of the business in order to save a certain number of jobs. While the previous version of Article 2112 was in effect, a number of laws derogating from the principle it established were introduced with the purpose of excluding the application of Article 2112 in cases of transfers by insolvent companies⁸¹.

⁸¹ See Article 1 of Law. No. 218 of 1978 which allowed the transferor to exclude the effectiveness of Art. 2112 where the undertaking had been declared in economic crisis and a collective agreement with the most representative trade union had been executed.

In 1990, Article 47 of Law No. 428 of 1990 transposed the Acquired Rights Directive in Italy. Article 47 amended Article 2112 of the Italian Civil Code. The latter, therefore, now reads as follows:

“In the event of the transfer of an undertaking, employment relationships are to continue to exist with the new owner and employees’ rights under those relationships are to be preserved.

The transferor and the transferee are jointly liable for all obligations in respect of the employees concerned by the transfer at the time of the transfer itself (...)

The transferee shall apply the collective agreements (...) in force at the time of the transfer until their expiration, unless they are replaced by other collective agreements applicable to the transferee’s business”.

Article 47 also introduces a mandatory information and consulting procedure with the trade unions (for undertakings with more than 15 employees) and expressly provides that the transfer cannot constitute in itself ground for dismissal of the employees.

Since Italian legislation had already introduced special provisions in the case of transfers made by insolvent companies, when Article 47 came into force, it – unlike the UK TUPE Regulations – provided, in paragraph (5), for derogation from Article 2112 of the Italian Civil Code in the case of insolvent business transfers.

4.2 Article 47(5) of Law No. 428 of 1990

Article 47(5) of Law No. 428 of 1990 refers to different situations:

- a) undertakings declared by the CIPI to be facing critical difficulties, pursuant to Article 2 (5) (c) of Law No. 675 of 12 August 1977; and
- b) undertakings subject to an insolvency procedure properly so called, namely either (i) declared bankrupted, or (ii) subject of an approved creditors’ arrangement and composition consisting in the disposal of assets, or (iii) subject to a compulsory administrative winding-up procedure which has been published, or (iv) subject to a special administration procedure, if no provision has been made for the continuation of the business or it has been finished.

In these situations, it provides that “if the consultation referred to in the foregoing paragraphs (with the employees’ representatives) has resulted in any agreement which provides for the maintenance of employed personnel, even in part, Article 2112 of the Civil Code shall not, unless the agreement lays down more favorable conditions, apply to the employees whose employment relationship continues with the transferee. Such an agreement may additionally provide that surplus personnel are to be excluded from the transfer and that the latter are to continue, wholly or in part, in the service of the transferor”.

4.3. Undertakings which have been declared to be facing critical difficulties pursuant to Article 2 (5) (c) of Law No. 675 of 1977.

Pursuant to Article 47(5), in the case of undertakings declared by the CIPI to be facing critical difficulties, it is sufficient that the mandatory consultation of the workforce result in an agreement providing for the continued employment of personnel, even in part, in order to exclude the application of Article 2112 of Civil Code. Article 47 (5) is intended to facilitate the transfer of an undertaking facing critical difficulties where there is a collective agreement on even the partial maintenance of employment. The transferee, in fact, will have the advantage of taking only those employees necessary to carry out the business. In turn, the transferor can proceed (immediately or later) to make reductions in the workforce. The transferor can also continue to make use of the remaining employees or, alternatively, can temporarily suspend their employment. In the latter case, the suspended employees will continue to have part of their wages guaranteed for a period of twelve months by the Government.

A finding by the CIPI that the undertaking is facing critical difficulties is conditional primarily and above all on circumstances relating to social policy rather than to the economic and financial situation of the undertaking in question, as in the case of insolvency proceedings. In order to be declared in critical difficulties, the undertaking is required to submit a restructuring program. The aim of that procedure is thus not to liquidate the debtor’s assets, as in insolvency proceedings. Any transfer of an undertaking in critical difficulties takes place as trading continues, without any interruption of productive activities.

The act by which an undertaking is declared to be in critical difficulties aims to enable the debtor undertaking to deal with temporary difficulties providing the workers with financial support for as long as those difficulties persist. The most important consequence of the declaration that the undertaking is in critical difficulties is that employees qualify for registration under the Cassa Integrazione Guadagni – Gestione Straordinaria (Special Department of the Wage Supplement Fund hereinafter referred to as “CIGS”). Under the CIGS system, employment relationships of all or part of the workforce are totally, or in part, suspended, and payment to workers of part of their remuneration is guaranteed by the CIGS.

Under the regime for undertakings in critical difficulties, no provision is made for judicial supervision at the initiation or in the course of the procedure, no suspension of payment is provided, nor are the debtor’s powers to deal with and manage its assets removed.

It is clear that the procedure in question did not have the characteristics of nor entailed consequences comparable with those of the procedures recognized by the ECJ (in *Abels* and *D’Urso*) as falling outside the scope of the Directive. However, Italian judges, rather than merely making use of the approach outlined by the ECJ in previous judgements on similar or related issues, “seem to have felt the necessity to ask for the support of the ECJ in order to obtain confirmation of the applicability of the ECJ’s previous decisions to the specific Italian situation”⁸².

The Italian Court, which made reference to the ECJ, recognized the possible clash between Article 47 (5) of Law No. 428 of 1990 and community law. The ECJ excluded the application of the Directive only when the transferor was subject to a proceeding aimed at the liquidation of the undertaking and the realization of its assets. Article 47 (5) of Italian Law No. 428 of 1990 equated such proceedings with the status of critical difficulties. That was unlikely to be compatible with the Directive. Undertakings in critical difficulties are in a state of serious indebtedness but their financial situation is manifestly less grave than that of an undertaking subject to bankruptcy proceedings. The business of an undertaking in critical difficulties is taken over by the transferee without

⁸² Leccese, Vito, *op. cit.*, n. 16 at 314.

any significant hiatus in production and, above all, with real prospects of recovery.

The ECJ, following its previous judgements, held that the Directive was applicable to the transfer of an undertaking which, under Article 2(5) (c) of Italian Law No. 675 of 1977, had been declared to be in critical difficulties. This was because an undertaking declared to be in critical difficulties is subject to a procedure aimed at the continuation of the business rather than its liquidation.

The Court did not even take into account Article 4 of the Directive and Article 47(4) of Law No. 428 of 1990. These provisions state that the transfer will not constitute grounds for dismissal by the transferor or the transferee but expressly exempt dismissals relating to economic, technical, and organizational reasons which entail changes in the workforce. These reasons always occur in the restructuring of undertakings in critical difficulties.

The ECJ's judgement in *Spano* has raised some doubts among Italian academic writers. As it has been noted, rules governing undertakings in critical difficulties constitute an autonomous regulatory system in respect to other insolvency proceedings. Indeed, they aim to protect collective and not individual interests while Article 2112 of Civil Code focuses on the individual rights of employees. A different treatment of undertakings in critical difficulties would, therefore, be justified on the basis of preserving jobs, which is the aim of such proceedings. Article 2112 of Civil Code and Article 47 (5) of Law 428 of 1990 would deal with different situations⁸³.

It also seemed that the ECJ was extremely concerned about the risk of a broad interpretation of the concept of undertakings in critical difficulties by domestic courts. However, Article 1 of law No. 223 of 1991 required the CIPI to establish, in advance, the requirements for an undertaking being declared in critical difficulties. This has substantially reduced the discretionary powers of the CIPI so that there is no more risk of a misinterpretation of the concept of critical difficulties⁸⁴.

⁸³ See Boscati, "Il trasferimento di aziende in crisi al vaglio della Corte di Giustizia", (1996) 6, *Law. Giur.*, p. 460 at 464.

⁸⁴ See Boscati, *op. cit.*, n. 82 at p. 465.

4.4 Undertakings subject to insolvency proceedings

Art. 47 (5) refers to several insolvency proceedings under Italian law: (i) bankruptcy proceedings properly so-called (“fallimento”); (ii) approved preventive arrangements and compositions (“concordato preventivo”); (iii) compulsory administrative winding-up procedure (“liquidazione coatta amministrativa”); and (iv) special administration procedure (“amministrazione straordinaria”).

Following the ECJ’s reasoning in *D’Ursò*, Art. 47 (5), with regard to undertakings subject to insolvency proceedings, expressly states that the derogation from Art. 2112 of Civil Code can only operate when not only (i) the mandatory consultation of the workforce has resulted in an agreement providing for the continued employment of personnel, even in part, but also (ii) no decision to continue trading has been taken with regard to the transferor company or it has already ceased trading.

Bankruptcy proceedings and compulsory administrative winding-ups are outside the scope of the Directive as interpreted by the ECJ. Some doubts might arise in the case of approved preventive arrangement and composition. However, this exemption from the application of Art. 2112 of Italian Civil Code might be considered as falling under Art. 4a (3) of the Amending Directive. This article states that, where the transferor is in a situation of serious economic crisis declared by a competent public authority under domestic provisions already existing in national law by July 17, 1998, a Member State may allow agreements between the transferee, the transferor, and employees’ representatives with the aim of introducing alterations to the employees’ terms and conditions of employment.

Article 47 (5), however, also includes in its scope the special administration procedure, which has different characteristics from those of the other proceedings mentioned in the same provision and which, before the introduction of Art. 47 (5), was the object of a preliminary ruling referenced to the ECJ by the Pretore di Milano in *D’Ursò*.

In *D’Ursò*, the Pretore di Milano raised the question of the compatibility of Art. 3 of Law No. 19 of 1987 which provides that, in the event of transfers of businesses or parts of businesses in the implementation of programs for undertakings under special administration, Art. 2112 of the Civil Code did not apply.

The Italian court referred to the ECJ the question of whether the Acquired Rights Directive was applicable to transfers of businesses made by undertakings under special administration.

The Court, recalling the principles developed in the earlier case of *Abels*, concluded that the Directive did not apply to transfers made by undertakings subject to a special administration, unless the continued activity of the business was envisaged and the business was still actually trading.

Following the preliminary reference in *D'Urso* and the infringement proceedings begun by the Commission against Italy with regard to Art. 3 of Law No. 19 of 1987, the Italian legislature passed Law No. 428 of 1990, which amended Art. 2112 of Civil Code as stated above.

Special administration was introduced by Law No. 95 of 1979. It applies (to the exclusion of cases of bankruptcy) to large undertakings⁸⁵. In order to apply the procedure, it is necessary that the judicial authorities (on their own initiative, or on the application of the undertaking itself, of the creditors, or of the Public Prosecutor) have declared the undertaking to be in a state of insolvency or to have failed to pay salaries for a period of three months.

The procedure is set in motion by ministerial decree and conducted by one or three auditors, appointed and supervised by ministerial authority. Subject to any contrary provision in Law No. 95 of 1979 itself, the special administration procedure is governed by the provision of Italian law on the compulsory administrative winding-up of undertakings. As a consequence, the organs of the undertaking cease their functions and lose their power to manage the undertaking and dispose of its assets.

The ministerial decree may allow the undertaking to continue to trade under the supervision of the auditor for a period not exceeding two years (which can be extended two times for a total period not exceeding a further two years). The auditor draws up a program which contains, as far as possible and taking into account the interests of creditors, a restructuring plan. The plan identifies the plants to be brought back into operation and those which must be transferred. The State may guarantee debts incurred vis-à-vis credit institutions in order to finance the day-to-day running.

⁸⁵ Undertakings with more than 300 employees for more than one year and whose debts to credit institutions and social security institutions exceed certain limits.

The ECJ, in *D'Urso*, held that the Acquired Rights Directive did not apply unless it has been decided that the undertaking is to continue trading. As in *Spano*, the judgment of the ECJ in *D'Urso* has been criticized by a number of Italian academic writers⁸⁶.

It has been noted that special administration is very akin to bankruptcy proceedings. As stated in the preamble to Law No. 95 of 1979, the purpose of the special administration procedure is to save parts of the undertaking concerned which are basically sound by transferring ownership of the undertakings – but not its debts – from the insolvent transferor to a transferee. As in bankruptcy proceedings, the process is based on the inability to meet liabilities and involves the transfer of assets.

Before the decision to commence the procedure is taken by ministerial decree, the court must first have declared a state of insolvency or failure to pay salaries. As in bankruptcy proceedings, a large public control is exercised over the commencement and course of the procedure. The only difference is that, while in bankruptcy proceedings it is the court that exercises such power of control, in special administration this supervision is exercised by an administrative authority. However, in a special administration procedure, a judicial intervention is also necessary in the first stage. The conduct of the procedure is supervised by an administrative authority because the restructuring of a large undertaking with a view to transferring a set of assets and maintaining jobs requires policy choices which can be better made by an administrative rather than a judicial authority.

The powers of disposal and management of the debtor subject to a special administration proceeding are similar to those of companies in liquidation. Indeed, Law No. 95 of 1979 expressly refers to bankruptcy legislation on compulsory administrative liquidation. This means that the debtor loses all powers of disposition and management, which are transferred to the auditor or auditors.

On the basis of the foregoing, the special administration procedure should have been treated as a bankruptcy proceeding even if the undertaking under

⁸⁶ See e.g. Romei, Roberto “Il trasferimento di un’azienda in crisi dinanzi alla Corte di Giustizia delle Comunità Europee”, (1995), *Mass. Giur. Lav.*, 492.

special administration had been authorized to continue trading. Such authorisation is merely incidental.

On several occasions, the Italian Supreme Court (“Corte Costituzionale”) has held the special administration procedure analogous to compulsory administrative winding-up⁸⁷ and recognized that the effects, in respect to creditors, are the same in special administration, bankruptcy, and compulsory administrative winding-up⁸⁸. All those similarities have been ignored by the ECJ, which, instead, extended as much as possible the scope of the Directive, although it entailed detrimental effects for employees⁸⁹.

Moreover, declaring the Directive inapplicable where trading ceases and applicable when the undertaking continues trading may lead to the consequence of immediate termination of trading, although this could be a less favorable solution from a social point of view. If special administration was not to be treated in a way analogous to bankruptcy proceedings, then debtors would seek application of the bankruptcy proceeding, instead of a special administration procedure, in order to escape the application of the Directive. This would be detrimental to the workers since only the special administration procedure, and not bankruptcy proceedings, aims to preserve jobs.

4.6 The “direct” approach of Italian courts

In the United Kingdom, the Acquired Rights Directive has been transposed into domestic law with remarkable lack of enthusiasm because of the difficulties in accommodating the new principle of compulsory transfer of the employment relationship with the traditional principle of freedom of contract and the practice of hiving-down. A first attempt was made to rely on a narrow interpretation of the 1981 Regulations. However, UK courts, after some initial hesitation and confusion, have given the Directive and the TUPE Regulations very wide application. British courts expressly applied the ECJ judgements to the national situation without feeling the need to make express reference for preliminary rulings to the ECJ. They have easily accepted the supremacy of EC

⁸⁷ Corte Costituzionale sent. n. 185 of 1987.

⁸⁸ Corte Costituzionale sent. n. 567 of 1989.

⁸⁹ See Foglia, Raffaele “Trasferimenti di aziende, procedure conservative e diritto comunitario”, (1991), II, *Dir. Lav.*, 329 at 338.

law and have applied the principles developed by the ECJ with positive enthusiasm. It has been suggested that the absence of a written constitution and Bill of Rights as well as a Constitutional Court to protect them might have facilitated the application of EC law and ECJ principles in the UK⁹⁰.

Moreover, UK courts also had the advantage of the prior domestic law being based on the opposite principle of freedom of contract in respect to the Directive, so once the new principle of compulsory transfer of employment relationship upon the transfer of business had been accepted, the UK courts could apply it without any concern of compatibility with previously existing domestic laws.

In Italy, the compulsory transfer of the employment relationship upon the transfer of a business was a traditional principle of domestic labor law. Since the late 1970s, Italian legislation has exempted transfers of undertakings by insolvent transferors from the application of the principle of compulsory transfer in the case of insolvent companies. At first sight, the task of the Italian courts should have been easier than that of the UK courts. However, the Italian courts faced the problem of potential conflict between pre-existing domestic laws and the case law of the European Court. Because of those difficulties, Italian courts made a number of references to the ECJ for preliminary rulings.

As an unexpected consequence, the British courts, without making express reference to the ECJ, put a heavy burden on the ECJ itself to give effective guidance to national courts, being at the same time free to adjust the ECJ reasoning, expressly made with reference to different domestic laws, to the national legislation. In contrast, Italian courts, by making a number of references for preliminary rulings to the ECJ, apparently seemed to turn the task of giving guidance to the national courts over to the ECJ. However, they had the reverse effect to be strictly bound by the ECJ rulings. In those judgements, as in *Spano* and *D'Urso*, the European Court did not take into account the peculiar characteristics of undertakings facing critical difficulties or subject to special administration under relevant Italian provisions, and simply applied the principles developed in its previous case law.

⁹⁰ See Davies, Paul "The European Court of Justice, National Courts and the Member States" in DAVIES, LYON-CAEN, SCIARRA and SIMITIS, *European Community Labour Law* (Oxford, 1996) 124-125.

5. The amendment of the Acquired Rights Directive

5.1 The revision process

Criticisms of the Acquired Rights Directive and the protectionist approach adopted by the ECJ – whose decisions rendered the Directive even more controversial – led to a long and difficult process of revision of the 1977 Directive.

The Commission put forward proposals for the revision of the Acquired Rights Directive in 1994. A revised draft was published in 1997 following heavy criticism of the initial proposals by the European Parliament⁹¹. The amending Directive was finally adopted on June 29, 1998⁹². The Amending Directive inserts new Articles 1-7b into the 1977 Directive. The new Directive does not seek to radically alter the scope and purpose of the original Directive, but instead seeks to consolidate the case law of the ECJ.

One notable aspect of the Directive is the flexibility it offers Member States. On a number of key issues (including its application in insolvency situations), Member States are granted the option of applying the Directive. While it is true that the original Directive also gave the Member States certain options, that text did not have the same degree of flexibility which characterizes the new Directive. The new approach adopted by the Council of the European Community is an example of the subsidiarity principle in action, and it also exemplifies the Community's current "light touch" approach to labor legislation in general.

5.2 Insolvent transferors

It is in relation to transfers by an insolvent transferor that the Amending Directive has effected the greatest changes. This is also the area in which the Amending Directive gives the greatest number of legislative choices to Member States.

Articles 4(1) and 4(2) have not changed: a transfer shall not constitute grounds for dismissal of an employee but dismissals may take place for economic, tech-

⁹¹ COM (97) 60 final, [1997] O.J. C124.

⁹² Council Directive 98/50, [1998] O.J. L201/88.

nical, or organizational reasons entailing changes in the workforce; Member States may exclude from that rule employees who are not covered by domestic protection against dismissal; and if, by reason of the transfer, the contract of employment is terminated because there is a substantial change in working conditions to the detriment of the employee, the employer is regarded as responsible for that termination.

However, there is a new Article 4a. The Amending Directive, unfortunately, adopts the distinction drawn in the case law of the ECJ between the liquidation of insolvent companies and other ways of dealing with them. It permits Member States to exclude the application of the Directive in cases where the undertaking, business, or part of the business being transferred “is the subject of bankruptcy proceedings or any analogous insolvency proceeding which have been instituted with a view to the liquidation of the assets of the transferor and are under the supervision of a competent public authority”⁹³.

The difficulty with this distinction is that “it focuses on the ultimate fate of the transferor, rather than on the position of the employees and the transferee when the viable parts of the business are sold, something that is a central feature of any procedure for handling insolvencies, whether through liquidation or otherwise”⁹⁴.

As a result of such distinction, practitioners will have an incentive to adopt the liquidation procedure instead of other proceedings aimed at rescuing the undertakings. The effect will be quite the opposite of the Directive’s purpose to protect employment.

The ability to exclude insolvent undertakings from the scope of the Directive is optional. It is for the Member States to decide. Therefore, Member States which do not take it up will be seen as including such insolvencies within the scope of the Directive.

Under Article 4a (2), irrespective of the choice made in relations to liquidations, the Member States may provide that the transferor’s debts (either in the form of arrears of payments, damages, or other liabilities) due before the business transfer or prior to the opening of insolvency proceedings do not pass to the transferee. The use of the word “debts” in the new provision is significant;

⁹³ Article 4a (1).

⁹⁴ Davies, Paul “Amendments to the Acquired Rights Directive”, (1998) 27, *ILJ*, p. 365 at p. 368.

the word used in Article 3(1) is "obligations", suggesting that it is only accrued and liquidated amounts which may be excluded from transfer, such as arrears of wages and salary or accrued holiday pay.

However, Member States wishing to take advantage of such a provision must be in compliance with the Insolvency Directive⁹⁵. That Directive requires Member States to guarantee employees' pay for specified periods in cases where the employer is insolvent. Member States are permitted to set a ceiling on the liability for employees' claims. Unless the above option is taken up, the principle of compulsory transfer of the contract of employment will entail the transfer of the above liabilities.

This option has been considered as "*simply a wealth transfer from the employees to the creditors of the transferor*"⁹⁶. Since the undertaking is free of debts arising from the contracts of employment, the transferor will be able to sell it at a higher price for the benefits of its creditors. The requirement of compliance with the Insolvency Directive does not help since the level of protection guaranteed by this Directive is notoriously low⁹⁷.

5.3 Variation of terms and conditions of employment upon the transfer of an insolvent company

In addition to, or instead of, the first option under Article 4 a (2), Member States can opt to allow the employer's and employees' representatives to agree to alterations in the employees' terms and conditions of employment "*designed to safeguard employment opportunities by ensuring the survival of the undertaking*". The agreement modifies the principle of the compulsory transfer of employment on the workers' existing terms and conditions. Such a modification was firmly rejected by the ECJ⁹⁸ and UK courts while, in Italy, it was a commonly accepted principle.

⁹⁵ Council Directive on the approximation of the laws of the Member States relating to the protection of employees in the event of insolvency of their employer, 80/987/EEC, [1980] O.J. L283/23. Under this Directive, some of the employees' claims unmet by the transferor and now not claimable against the transferee are paid out of a government-financed guarantee fund.

⁹⁶ Davies, Paul *op.cit.*, n. 93 at 368.

⁹⁷ Indeed, under the Insolvency Directive, Member States may restrict the fund's liabilities both in terms of time and level of payment.

⁹⁸ C- 324/86 *Forningen af Arbejdsledere i Danmark v. Daddy's Dance Hall A/S*, [1988] ECR 739; C-209/91 *Rask v. ISS Kantineservice A/S*, [1993] ECR I-5755; *Credit Suisse First Boston (Europe) Ltd v. Lister* [1998] IRLR 700, C.A.

As highlighted by Shrubsall⁹⁹, the UK Court of Appeal decision in *Wilson v St Helens Borough Council and Meade & Baxendale v British Nuclear Fuels*¹⁰⁰ established that, if there is a transfer of an undertaking and employees are transferred, their terms of service cannot be varied lawfully for a reason connected to the transfer, even if the employees consent to the variation and, it seems, regardless of how long after the transfer the variation is made. In reaching that decision, the Court of Appeal purported to follow the decision of the ECJ in *Daddy's Dance Hall*¹⁰¹. In this case, it was held that a worker could not waive the rights conferred upon him by the mandatory provisions of the Directive, even if the disadvantages were offset by advantages so that, overall, he would not be left in a worse position. However, the ECJ did not prevent variations by agreement between the parties in cases where the reason is unconnected to the transfer¹⁰².

Wilson and *Meade* endorsed the principle that the validity of downward variation of terms hinges on whether or not that variation is for a reason connected with the transfer. Lord Slynn thought that the tribunal and the Court of Appeal in *Wilson* were entitled to find that the transfer of the undertaking was not the reason for the variation and so the variation would have been effective even without the dismissals. In *Meade*, there was no such finding but, since the dismissals were effective and the employees had received substantial compensation for loss of employment, they were free to agree to re-engagement terms with the transferee employer. There was no variation, but a dismissal and re-engagement¹⁰³.

As clearly highlighted by Shrubsall “the House of Lords judgment did not resolve the conundrum that if it is not lawful for the transferee of an undertaking to negotiate consensual variation in the terms of employment of the existing workforce as part of a transfer, a business which is in financial difficulties, but which might be saved by re-organization, cannot be rescued”, so that “the result might be that the undertaking is forced into closure and all jobs are lost:

⁹⁹ Shrubsall, “Employment Rights and Business Transfers - Changes to the Acquired Rights Directive”, at http://webjcli.ncl.ac.uk/1998/issue5/maps/b-bar.map.shrubsall5_files/bar.gif.

¹⁰⁰ [1997] IRLR 505

¹⁰¹ Case C- 324/86 [1988] ECR 739.

¹⁰² Shrubsall, “Employment Rights and Business Transfers - Changes to the Acquired Rights Directive”, op. cit..

¹⁰³ Shrubsall, Vivien, “Employment Rights and Business Transfers - Changes to the Acquired Rights Directive”, (1998) Web Journal of Current Legal Issues.

the consequence of an interpretation of a Directive which was meant to protect jobs. The employer can dismiss and re-engage on different terms, but if he does and the defense of economic, technical, or organizational reason is not made out, he will incur liability in an unfair dismissal”¹⁰⁴.

The new Article 4a provides a partial solution. Article 4a paragraph 2(b) permits Member States to provide that, on a transfer during such insolvency proceedings, employees' representatives may agree to alterations in the employees' terms and conditions of employment "designed to safeguard employment opportunities by ensuring the survival of the undertaking". Like the Italian legislator, the Council of the European Communities opted for a collective protection of employees' rights. In other words, if some individuals may be considerably worse off as a result of the agreement, the latter will nevertheless benefit the employees as a whole. Concerns have been expressed about the great degree of flexibility and bargaining power which may arise from this provision for the employer¹⁰⁵. As a response to those concerns, Art. 4a(4) of the Directive states that “Member States shall take appropriate measures with a view to preventing misuse of insolvency proceedings in such a way as to deprive employees of the rights provided for in this Directive”.

However, the new provision allows for negotiated and consensual variation only in cases where the undertaking is already the subject of insolvency proceedings and the purpose must be to ensure the survival of the business. Article 4a (3) contains a special provision allowing one Member State – which, like Italy, already has special national procedures to promote the survival of companies declared to be in a state of economic crisis – to agree to the alteration of employment terms in such cases.

5.4 The impact of the Amending Directive on employees' rights and the process of transposition in the UK and Italy

Although the Amending Directive introduces welcome clarifications with regard to the transfers of undertakings in the context of insolvency proceedings, there are many gray areas. The Amending Directive adopted the distinction

¹⁰⁴ Shrubsall, “Employment Rights and Business Transfers - Changes to the Acquired Rights Directive”, *op. cit.*

¹⁰⁵ Hardy, Stephen – Painter, Richard W, “The new Acquired Rights Directive and its Implications for European Employees Relations in the Twenty-First Century”, (1996) 6 (4) *Maastricht J. Eur. Law* 366 at 378.

drawn by the ECJ between insolvency and pre-insolvency proceedings. The EU Commission did not take the opportunity to give more general application to the principle of collectively agreed upon variation in the terms and conditions of employment. The Amending Directive allows such variations only in the context of insolvent business transfers. Finally, in the interest of certainty, it does not indicate, as suggested by the House of Lords in 1996 and so far as it was practicable, the insolvency procedures of each Member State to which the Directive applies¹⁰⁶.

Moreover, the flexibility which characterizes the new Directive has raised different comments. It has been argued that the Amending Directive does little to advance the cause of employment protection in the context of insolvency proceedings since it gives EU Member States a wide degree of discretion in terms of the type and strength of protection to offer¹⁰⁷. In contrast, Ian McCartney, Minister of State at the UK Department of Trade and Industry, asserted that the Amending Directive “*will help competitiveness and employment flexibility, by helping the labour market to adapt to structural change in the economy without walking over the rights of employees*”¹⁰⁸.

There is no doubt that the Amending Directive has the effect of reducing employees’ formal legal entitlement. Whether, in turn, employees can expect to enjoy greater substantive job protection is an issue not yet resolved. The changes in the area of insolvency are essentially deregulatory and their ultimate impact will depend heavily on the choices made by the Member States at the point of implementation¹⁰⁹. However, the transposition process of the Amending Directive into domestic law has, so far, been very slow if the deadline for the transposition was July 17, 2001.

In the meantime, on March 12, 2001, the Council of European Communities adopted Directive 2001/23/EC¹¹⁰ which simply codifies – in the interests of clarity and rationality¹¹¹ – the amendments to the Acquired Rights Directive by the Amending Directive. However, Directive 2001/23/EC does not preju-

¹⁰⁶ House of Lords Select Committee on the European Communities: “Transfer of Undertakings: Acquired Rights” Session 1995-96, 5th Report, HL Paper 38 p. 21.

¹⁰⁷ Hardy, Stephen – Painter, Richard W, *op.cit.*, n. 100 at 378

¹⁰⁸ Speech reported in DTI Press Release P/98/430 of June 4, 1998.

¹⁰⁹ Davies, Paul, *op. cit.*, n. 93 at 372.

¹¹⁰ OJ 2001 L 201/16

¹¹¹ See the preamble to Directive 2001/23/EC

dice the time limits within which the Member States are to comply with the Amending Directive.

5.5 The transposition process in Italy

Recently, the legal debate regarding the compliance of the Italian labor law order with the second generation directives on the transfer of overtakings has seen a complex dialogue involving statutory and judicial interventions. In particular, the Italian Legislation enacted three Legislative Decrees regarding this institute (Legislative Decree No. 18/2001; Legislative Decree No. 276/2003, Articles No. 29, paragraphs 3 and 32, Legislative Decree No. 251/2007, Article No. 9) and, on the other side, the European Court of Justice delivered many important judgments that witnessed the evolution of the transfer of undertakings discipline¹¹². Furthermore, Italian Corte di Cassazione committed itself to a long-distance dialogue with ECJ case law in an attempt to apply Italian law in full compliance with the principles of the previously indicated Directives as well as with the related interpretation established by the ECJ¹¹³.

It should be highlighted that the indicated Decrees do not contain any provision amending the previous regime of transfer of insolvent companies. In fact, Legislative Decree No. 18/2001 only amends Article 47, paragraphs (1) (2) (3) and (4) of Law No. 428 of 1990, but does not refer to paragraph (5) which, as discussed in Chapter III, exempts insolvent business transfers from the scope of Art. 2112 of Italian Civil Code. Article 47 (5) must be considered to still be in force.

¹¹² See. Case C-343/98, Renato Collino and Luisella Chiappero v Telecom Italia SpA, [2000] ECR 6659; C 175/99, Didier Mayeur v Association Promotion de l'Information Messine (APIM), [2000] ECR 7755; C-172/99, *Oy Liikenne Ab v Pekka Liskojärvi and Pentti Juntunen*, [2001] ECR 745; C-51/00, *Unión de Pequeños Agricultores v Council*, 2002 ECR 6677; C-164/00, *Katia Beckman v Dynamco Whicheloe Macfarlane Ltd*, [2001] ECR 4893; C-145/01, *Commission of the European Communities v Italian Republic*, [2003] ECR 5581; C-4/01, *Martin and Others v. South Bank University*, [2003] ECR 12859; C-340/01 *Carlito Abler v Sanrest Grosskuechen*, [2003] ECR I-14023; C-333/03, *Commission of the European Communities v Grand-Duchy of Luxembourg*, [2004] 6033; C-425/02, *Johanna Maria Delahaye, née Delahaye v Ministre de la Fonction publique et de la Réforme administrative*, [2004] ECR 823; C-478/03 *Celtec Ltd v John Astley and Others*, [2005] ECR 4389; C-297/03, *Sozialhilfverband Robrbach v Arbeiterkammer Oberösterreich, Österreichischer Gewerkschaftsbund*, [2005] ECR 04305; Joined cases C-232/04 and C-233/04, *Nurten Güney-Görres, Gul Demir v Securicor Aviation (Germany) Ltd, Kötter Aviation Security GmbH & Co. KG*, [2005] ECR 11237; C-499/04, *Werhof v Freeway Traffic Services GmbH & Co KG ECJ*, [2006] ECR 2397; C-458/05 *Mohamed Jouini and Others v Princess Personal Service GmbH (PPS)*, [2007] ECR 7301.

¹¹³ Cass. civ. Sez. lavoro, 18/01/2007, n. 1097; Cass. civ. Sez. lavoro, 11/01/2007, n. 398; Cass. civ. Sez. lavoro, 06/11/2003, n. 16673, Cass. civ. Sez. lavoro, 12/05/1999, n. 4724

As indicated before, some authors¹¹⁴ expressed doubts regarding the compatibility of this provision with the Directive 77/187, and, after the Spano judgement, Italian doctrine divided itself in two currents of thoughts in defining the consequences of the same judgement.

Some authors¹¹⁵ affirmed that the relevant Directive, as interpreted by ECJ, should prevail on Article 47, paragraph (5), of Law No. 428/1990, which should therefore cease to be applied. Others, on the contrary, noted that the directive could not have any direct efficacy for individual relationships, so the indicated national provision should be applied to further legislative reform¹¹⁶. This reconstruction was used by the Corte di Cassazione in the *New Holland Italia* case¹¹⁷, in which the Corte affirmed that the non-compliance of the national rule with the relevant Directive, under the interpretation offered by the ECJ in the Spano case, cannot preclude the application of Article 47, paragraph 5, not only because the original Directive could not have been enforced in private relationships, but also because, in the opinion of the Corte, there was no space for a restrictive interpretation of the national law. Furthermore, some Authors has highlighted the possibility of the workers bringing an action against the State for the possible non-application of Article 47, paragraph (5), of Law No. 428/1990¹¹⁸. However, as indicated before, the Directive 98/50, in Article 4-bis, paragraph 3 (now Article 5, paragraph 3, of the Directive 2001/23) states that “a Member State may apply paragraph 2(b)¹¹⁹ to any transfer where the transferor is in a situation of serious economic crisis, as defined by national law, provided that the situation is declared by a competent public authority and open to judicial supervision, on the condition that such provisions already existed in national law on July 17, 1998”. As indicated by the

¹¹⁴ *Ex plurimis* DE LUCA, “Salvaguardia dei diritti dei lavoratori in caso di trasferimento d’azienda: funzione del diritto comunitario e della giurisprudenza della Corte di giustizia nella interpretazione e nell’applicazione della nuova disciplina nazionale”, *Foro It.*, IV, 288

¹¹⁵ LAMBERTUCCI (1996), “La disciplina del trasferimento d’azienda in crisi al vaglio della Corte di Giustizia”, *Rivista italiana di diritto del lavoro*, II, p. 274.

¹¹⁶ SANTORO PASSARELLI (2005), “*Il trasferimento di parte dell’azienda tra libertà dell’imprenditore e tutela dei lavoratori*”, AA.VV. “Dialoghi tra dottrina e giurisprudenza”, p. 28.

¹¹⁷ Cass., Sez. Lav. 21.3.2001, n. 4073, (2001), I, *Foro it.*, 3 235, with a note by Cosio.

¹¹⁸ PELAGGI (1998), “Trasferimento d’azienda nelle imprese in crisi, potere di recesso del cedente e del cessionario ed effetti del licenziamento illegittimo alla luce della giurisprudenza comunitaria”, *Massimario di Giurisprudenza del Lavoro*, p. 628.

¹¹⁹ Which states that: “The transferee, transferor or person or persons exercising the transferor's functions, on the one hand, and the representatives of the employees on the other hand may agree alterations, in so far as current law or practice permits, to the employees' terms and conditions of employment designed to safeguard employment opportunities by ensuring the survival of the undertaking, business or part of the undertaking or business”.

last clause, this rule, for a part of the doctrine¹²⁰, aims directly to provide a solution to all previous uncertain situations, as if, in a certain sense, the rule itself would have been enacted in order to legitimate the peculiar Italian regime of transfer of undertakings in crisis that would remain fully operable. Some doubts regarding the consistency of the Italian law, even with the second generation directive, still persist, especially in light of the recent European Court of Justice case law. In fact, the ECJ, in Case 145/01 (*Commission of the European Communities v. Italian Republic*)¹²¹, the Court, in an obiter dictum, affirmed that Article 47(5) and (6) of Law No. 428/1990 (...) may well, at least partially, correspond to the situations contemplated in Article 4a". In other words, it seems that the Court would state only a partial legitimization of Article 47, paragraph 5, of Law No. 428/1990.

Which is then the legitimate space of operability of the national provision? It appears possible to affirm that Article 47 could be legitimately applied consistently with the Directive only in the case of a "serious economic crisis" that would lead the overtaking to a pre-liquidation status. This reconstruction seems to be coherent with the text of Directive 2001/23 and, most relevantly, with the ECJ case law connected to the enforcement of the first generation Directive (77/187), which excluded its operability if the purpose of the procedure was the liquidation of the whole business.

But what is the fate of the other profiles of the national rule that do not comply with the Directive? The problem is the question concerning the horizontal direct efficacy of self-executing directives. The exclusion of any horizontal direct effect is affirmed constantly by the ECJ. In the famous judgment *Faccini Dori*¹²², it has been stated that "as the Court has consistently held since its judgment in Case 152/84 *Marshall v Southampton and South-West Hampshire Health Authority* [1986] ECR 723, paragraph 48, a directive cannot of itself impose obligations on an individual and cannot therefore be relied upon as such against an individual" and that "the effect of extending that case law to the sphere of relations between individuals would be to recognize a power in

¹²⁰ MENGHINI (2000), "L'attenuazione delle tutele individuali dei lavoratori in caso di trasferimento d'azienda in crisi o soggetta a procedure concorsuali dopo la direttiva 50/98 e il d.lgs. 270/99", *Rivista giuridica del lavoro e della previdenza sociale*, p. 229; LAMBERTUCCI (1999), "Le tutele del lavoratore nella circolazione dell'azienda", Giappichelli, Torino, pp. 74 - 75; VILLANI (2000), *Trasferimento d'azienda. Profili di diritto del lavoro e della previdenza sociale*, Utet, Torino pp. 174 - 175.

C-145/01, *Commission of the European Communities v Italian Republic*, [2003] ECR 5581, par. 16.

¹²² C-91/92, *Paola Faccini Dori v Recreb Srl*, [1994] ECR 3325.

the Community to enact obligations for individuals with immediate effect, whereas it has competence to do so only where it is empowered to adopt regulations". Nor does it appear possible to recognize an "indirect" horizontal effect to the Directives, considering that in the *Marleasing* judgement¹²³, the Court clearly stated that this peculiar effectiveness would be possible only in the case of "soft interpretation" and not in the case of "hard interpretation", the first defined as an operation in which the judge attributes meanings consistent with European law to ambiguous legislative texts, the second defined as the enforcement of a meaning which is different from the one directly emerging from the legal text, which is performed in order to define an interpretation which is systematically consistent with European law. As a matter of fact, it must be remembered that the full adaptation of Italian law to the European provisions always remains a legislative operation, and cannot be judicially implemented.

In conclusion, the part of Article 47, paragraph 5, of Law No. 428/1990 that appears to remain non-compliable with the second generation directive will continue to be enforced in the Italian legal order, considering, as above, that the transfer of undertaking Directive cannot be directly enforced in the individual relationship and that a "hard interpretation" does not appear legitimate.

5.6 The transposition process in the UK¹²⁴

The enactment of the second generation Directives determined an amendment of the TUPE regulation (SI 2006/246). In particular, the new TUPE regulation applies to a transfer of an undertaking, business, or part thereof where there is a transfer of an "economic entity", which is defined as "an organised grouping of resources which has the objective of pursuing an economic activity, whether or not the activity is central or ancillary"¹²⁵. For most businesses, deploying mixed resources to further commercial activity, the test for application of the regulation is whether the commercial activity, together with the sufficiency of the resources deployed, passes from the transferor to the transferee so that the

¹²³ C-106/89, *Marleasing S.A v La Comercial Internacional de Alimentacion S.A*, [1990] ECR 1839.

¹²⁴ SHRUBSALL (2006), "The New TUPE Regulation", *New Law Journal*, p. 584.

¹²⁵ TUPE, reg. 3, par. 2.

entity is recognizable in the hands of the transferee. As indicated by Shruballs, it seems that the renewed TUPE tends to resolve the problems linked to the transferor's labor-only or labor-intensive service entities¹²⁶.

In fact, the European Court of Justice, in Case C-13/95 (*Süzen case*)¹²⁷, made Council Directive 77/187 inapplicable to a transfer of such an entity unless the transferee takes on employees as well as the commercial activity on which they are deployed. Since then, British Courts and Tribunals have faced many difficulties in interpreting, applying, distinguishing, and restricting the *Süzen* principle, with deep uncertainty over circumstances in which TUPE regulations may cover changes of service provision contracts and doubts over the compatibility with the European law of the relevant UK case law¹²⁸. However, during the drawn-out consultation, the government has made clear its intention to include changes of service provision contracts within the TUPE regulations' ambit.

The provisions provide that the first and second generation contracting-out of services and the bringing in-house of previously contracted out services will all be subject to the TUPE regulations whenever an "organized grouping of employees...has as its principal purpose the carrying out of the activities"¹²⁹ under the service contract. The only exception is service contracts intended by the client to be in connection with a single and specific event or task of short term duration¹³⁰.

At earlier stages of consultation, an exception for professional services was mooted and included in the draft regulations published in March 2005. However, the government was convinced that the disadvantages of any such provisions – and the practical difficulty of providing for an effective and appropriate definition – outweighed the gains achieved. Therefore, no such exception is included in the TUPE regulation amendment.

So, changes of contractors providing office cleaning, workplace catering, security and guarding duties, refuse collection, and machinery maintenance are now included in the scope of the new TUPE regulations¹³¹. For the TUPE

¹²⁶ SHRUBALLS, *op. cit.*

¹²⁷ C-13/95, *Ayşe Süzen v Zehnacker Gebäudereinigung GmbH Krankenhausservice*, [1997] ECR 1259.

¹²⁸ For the UK recent case law see Underwood, "TUPE Round-Up", 8.6, *Emp. Law & Lit.*, p. 21

¹²⁹ TUPE, reg. 3, par. 3.

¹³⁰ SHRUBALLS, *op. cit.*

¹³¹ That includes also legal, personnel, auditing, debt collection or other financial, managerial, or support services.

regulation to apply in any such case, the outgoing provider of services must have deployed an “organised grouping of employees” on the performance of the contract services.

It must also be highlighted that the new TUPE regulations specifically provide that a single employee can be regarded as an organized grouping of employees – endorsing Case C-392/92 (Schmidt case)¹³² – and the reference to “principal purpose” means that the employees do not have to be exclusively deployed on the specific contract service. Therefore, their employment in peripheral or occasional tasks outside that contract would not jeopardize the status of the economic entity. The new TUPE regulations do not apply in cases where the contract activities wholly or mainly supply goods for the client’s use, as it applies to service provision contracts only¹³³.

The TUPE also redefined the transferor notification obligations. In particular, the transferor must notify the transferee in writing or in a readily accessible form of “employee liability information” relating to any employee assigned to the undertaking or service contract being transferred¹³⁴. This information includes:

- the identity and age of the employee;
- the employment particulars required by the written statement provisions of the Employment Right Act (ERA 1996), s. 1¹³⁵;

¹³² C-392/92, *Christel Schmidt v Spar- und Leihkasse der früheren Ämter Bordesholm, Kiel und Cronshagen*. [1994] ECR 1311.

¹³³ SHRUBSALL, *op. cit.*

¹³⁴ TUPE reg. 11.

¹³⁵ Which states that:

- (1) Where an employee begins employment with an employer, the employer shall give to the employee a written statement of the particulars of employment.
- (2) The statement may (subject to section 2(4)) be given in installments and (whether or not given in installments) shall be given no later than two months after the beginning of the employment.
- (3) The statement shall contain particulars of—
 - (a) the names of the employer and employee,
 - (b) the date when the employment began, and
 - (c) the date on which the employee’s period of continuous employment began (taking into account any employment with a previous employer which counts toward that period).
- (4) The statement shall also contain particulars, as at a specified date not more than seven days before the statement (or the instalment containing them) is given, of—
 - (a) the scale or rate of remuneration or the method of calculating remuneration,
 - (b) the intervals at which remuneration is paid (that is, weekly, monthly, or other specified intervals),
 - (c) any terms and conditions relating to hours of work (including any terms and conditions relating to normal working hours),
 - (d) any terms and conditions relating to any of the following—
 - (i) entitlement to holidays, including public holidays and holiday pay (the particulars given being sufficient to enable the employee’s entitlement, including any entitlement to accrued holiday pay on the termination of employment, to be precisely calculated),

- information on any disciplinary or grievance procedures in respect to an employee within the previous two years;
- information on any court or tribunal case, claim, or action brought by an employee within the previous two years or that the employer has reasonable grounds for believing may be brought; and
- information on any collective agreement which will take effect after the transfer in relation to any employee transferred.

This information must be given not less than 14 days before the relevant transfer, or, in special circumstances, as soon as reasonably practicable thereafter. Any changes in the information after the notification must also be noted to the transferee. A claim for breach of this obligation to an employment tribunal must normally be made within three months of the transfer¹³⁶.

Regarding the choice of the employees to be transferred, the 2006 TUPE amendments elevate to a statutory basis the ECJ decision in Case C-183/86¹³⁷ that the employees who transfer will be those assigned to the part transferred. Assigned is stated to mean “assigned other than temporary basis”¹³⁸. The identification of which employees are assigned where will be a matter of fact for

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- (ii) incapacity for work due to sickness or injury, including any provision for sick pay, and
 - (iii) pensions and pension schemes,
 - (e) the length of notice which the employee is obliged to give and entitled to receive to terminate his contract of employment,
 - (f) the title of the job which the employee is employed to do or a brief description of the work for which he is employed,
 - (g) where the employment is not intended to be permanent, the period for which it is expected to continue or, if it is for a fixed term, the date when it is to end,
 - (h) either the place of work or where the employee is required or permitted to work at various places, an indication of that and of the address of the employer,
 - (j) any collective agreements which directly affect the terms and conditions of the employment, including where the employer is not a party, the persons by whom they were made, and
 - (k) where the employee is required to work outside the United Kingdom for a period of more than one month—
 - (i) the period for which he is to work outside the United Kingdom,
 - (ii) the currency in which remuneration is to be paid while he is working outside the United Kingdom,
 - (iii) any additional remuneration payable to him, and any benefits to be provided to or in respect of him, by reason of his being required to work outside the United Kingdom, and
 - (iv) any terms and conditions relating to his return to the United Kingdom.
 - (5) Subsection (4)(d)(iii) does not apply to an employee of a body or authority if—
 - (a) the employee's pension rights depend on the terms of a pension scheme established under any provision contained in or having effect under any Act, and
 - (b) any such provision requires the body or authority to give to a new employee information concerning the employee's pension rights or the determination of questions affecting those rights.

¹³⁶ SHRUBSALL, *op. cit.*

¹³⁷ C-186/83, *Arie Botzen and others v Rotterdamsche Droogdok Maatschappij BV*, [1985] ERC 519.

¹³⁸ TUPE, reg. 2, p. 1.

the tribunal in any particular case. In particular, *Duncan Web Offset (Maidstone) Ltd v Cooper* (1995) IRLR 633 makes the following factors relevant:

- the amount of time spent on one part of business or the other;
- the amount of value given to each part by the employee;
- the term of the contract showing what the employee could be required to do;
- how the cost to the employer of the employee's service had been allocated between the parts of the business; and
- which part of the business manages the employees.

The new provision also put the House of Lords' decision in *Lister v Forth Dry Dock and Engineering Co Ltd* (1990) 1 AC 546, (1989) 1 All Er 1134 into place on a statutory basis. Consequently, the TUPE regulation protects those employees who would have been employed at the time of the transfer if they had not been dismissed before it and because of it.

Regarding the dismissal issues, the TUPE regulation clarifies that a dismissal or variation of contract terms is permitted in cases where there is an ETO reason entailing changes of the workforce. Obviously, employees affected will be entitled to redundancy compensation, but will not be treated as unfairly dismissed, provided that the usual procedural and substantive standards of fairness set out in ERA 1996, s 98(4) are met¹³⁹.

Finally, the amendments to TUPE introduced special provisions to facilitate the transfer of insolvent undertakings. In particular, certain of the transferor's pre-existing debts owed to affected employees do not transfer to the transferee, but are charged instead to the National Insurance Fund, and, fulfilling the obligations deriving from the second generation Directives, stated that, exceptionally, employers and employees representative are allowed to agree to the downward variation of employment contract terms to ensure the survival of the transferring business¹⁴⁰.

However, for these provisions to apply, the transferor must be subject to "relevant insolvency proceedings", defined as insolvency proceedings under

¹³⁹ SHRUBSALL, *op. cit.*

¹⁴⁰ TUPE reg. 8-9.

the supervision of an insolvency practitioner opened in relation to the transferor but not with the purpose of liquidating the assets. The phrase covers any collective insolvency proceedings in which the whole or part of an undertaking is transferred to another entity as a going concern, but it does not cover any winding-up proceedings by either members or creditors where there is no such transfer. This therefore excludes bankruptcy, because the need to realize the assets of the undertaking takes precedence over the rights of the employees of the business.

In those other cases where the transferor is insolvent but is the subject of a rescue procedure, such as administration, company, and individual voluntary arrangements, TUPE still applies although the Regulation offers a new flexibility to the insolvency practitioner whose purpose is to ensure the survival of the undertaking and the ability to sell it on as a going concern¹⁴¹. This flexibility is achieved by:

- a. defining a limit on debts owed to employees passing to the transferee; and
- b. admitting changes to an employee's terms when this is to assist the survival of the undertaking or business.

In fact, when the transferor is in one of the insolvency proceedings which aims to rescue the undertaking, the Government has agreed to subsidize that rescue by relieving the transferee of debts owed to employees which might otherwise have passed with the business. This establishes that all employees whose contract of employment transfers by operation of the regulation will be eligible for the statutory insolvency payments set out in Part XII of the Employment Rights Act 1996 ("ERA")¹⁴². These are usually available only when employment is terminated due to insolvency, but Reg. 8 (3) deems the employees' contracts to have been terminated (even though they have not been), with the date of the transfer being treated as the date of termination, in order to allow them to claim from the National Insurance Fund for statutory redundancy pay, pay arrears (up to eight weeks), pay in lieu of notice, holiday pay (up to six

¹⁴¹ Dhinsa, (2006), "The draft TUPE Regulation and insolvency", *Insolvency Intelligence*, 19 (1), pp. 8-10.

¹⁴² Dhinsa, *op. cit.*, at. 9.

weeks), or a basic award of compensation for unfair dismissal: the transferee is relieved of these debts, which are met instead by the NIF, but any debts beyond those so met will pass to the transferee in the usual way. It is clear that these provisions will make it easier for the practitioner to sell the business as a going concern by relieving the burden of its associated employee debts, thereby making it more attractive to a potential purchaser¹⁴³.

As it was under the old regulation, any variation in the terms of employment under the TUPE will be void if the reason for the variation is the transfer itself or a reason connected with the transfer which is not an ETO reason entailing changes in the workforce. However, the new TUPE introduces a carve-out from this rule, establishing that where there are “relevant insolvency proceedings”, the transferor, transferee, or insolvency practitioner may vary employment terms – e.g. reduce pay, overtime, or shift supplemental rates – provided agreement is reached with the employees’ representatives.

This measure is clearly intended to remedy the inflexibility of the original TUPE, which brought the House of Lords, in *Wilson v. St. Helens’ Borough Council*¹⁴⁴, to hold that if the employees are transferred on the relevant transfer of undertakings under the TUPE Regulation, their terms and conditions cannot lawfully be varied for a reason connected to the transfer, regardless of whether they consent to the variation and regardless of how long after the transfer they have been made. This meant, as indicated previously, that the only reliable way for an insolvent business to secure a change of terms would be to dismiss the employees and offer them employment on revised terms¹⁴⁵.

However, in order to ensure the effectiveness of the changes in the terms of employment, the practitioner has to adhere to the procedure provided for by Reg. 9. This includes, for example, ensuring that employee representatives with whom the administrator intends to negotiate are properly selected, that where these representative are non-union, the agreement is in writing and signed by each representative, and a copy of the agreement is provided to all employees to whom it is intended to apply¹⁴⁶.

¹⁴³ Dhinsa, *op. cit.*, at. 10.

¹⁴⁴ [1999] 2 A.C. 52.

¹⁴⁵ Dhinsa, *op. cit.*

¹⁴⁶ Dhinsa, *op. cit.*

The variation must be designed to safeguard employment opportunities by ensuring the survival of the business transferred, and so it must be shown that a reduction in employment costs is necessary to make the continuation of the business commercially viable. When this insolvency provision applies, an ETO reason for the variation is not required¹⁴⁷.

6. Conclusions

This work has traced the application and revision process of the Acquired Rights Directive in the context of insolvency proceedings, focusing on the role of community and national (British and Italian) case law.

This process has moved through several stages. In the first stage, the European Court of Justice was the principal actor. Being called upon by the Member States to decide whether the scope of the Directive extended to a situation in which the transferor of an undertaking was adjudged insolvent, the ECJ widely interpreted the Directive. It held that the Directive did not apply to proceedings designed to liquidate the transferor's assets while it did apply to proceedings in which the main purpose was to safeguard the assets and, where possible, to continue the business of the undertaking. Applying this reasoning in other judgements, the Court held that the Directive did apply to transfers by undertakings under the Italian special administration of large undertakings¹⁴⁸, to transferors which had been declared to be in critical difficulties under the relevant Italian provisions and to transfers made by companies in judicial or voluntary winding-ups under relevant Belgian law.

In the second stage, the national courts had to apply the principles established in the case law of the ECJ in domestic insolvency proceedings. British courts, once they had accepted the new principle of compulsory transfer of employment relationships upon the transfer of a business adapted (although not without technical difficulties) the principles developed by the ECJ to domestic law.

¹⁴⁷ Dhinsa, *op. cit.*

¹⁴⁸ The Directive does apply in cases where the ministerial decree which sets the special administration procedure in motion has authorized the undertaking to continue trading.

Italian courts, in contrast, facing pre-existing national laws partially in conflict with the Directive, and made a number of references for preliminary ruling to the ECJ. In the possible clash between those opposing interests, the Italian courts granted absolute priority to the protection of employees' rights.

In this second stage, academic writers have emphasized the problems arising from the application of the Directive to the transfer of insolvent businesses. The prospect of taking over accrued liabilities under employment contracts might deter a prospective transferee from purchasing the insolvent businesses. Therefore, a directive designed, at least in part, to facilitate the transfer of business might act as a deterrent to such transfers and as an impediment to the rescue of businesses.

Moreover, in order to reduce the risk of a connection with any subsequent transfer, insolvency practitioners might make dismissals at an earlier stage than they would otherwise, with the unintended result being that the effect of a Directive aimed at the protection of employment would reduce job security.

The result of such a dialogue carried out by national courts and the European Court of Justice has been a new Directive amending the previous one, which adopts much of the jurisprudence emanating from the decisions of the ECJ.

The Amending Directive granted Member States a wide degree of discretion. However, it still contains some provisions likely to be heavily discussed. The balance between the interests of workers and those of other creditors has not yet been defined in a satisfactory way.

The difficult task of finding a reasonable balance in this area is still in the hands of Member States. In this sense, the recently introduced TUPE amendments seem to define a coherent interaction between the conflicting interests. The effectiveness of this model, however, still has to be tested in real world business (and insolvency) practices.

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